

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

August 28, 2015

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

PSF: 15HD-121

Hawaii

Consent to Assignment of General Lease No. S-3591 from Vetpro, Inc., Assignor, to Jieyu Shepard, Assignee; Amendment of Terms and Conditions Regarding Allowed Use, Assignment and Sublease Provisions for General Lease No. S-3591; and Approve Lease Term Extension Pursuant to Act 207, Session Laws of Hawaii 2011, General Lease No. S-3591, Kanoelehua Industrial Lots, Waiakea, South Hilo, Hawaii, Tax Map Key: (3) 2-2-049:017.

APPLICANT:

Vetpro, Inc., a Hawaii corporation, as assignor, to Jieyu Shepard, single, tenant in severalty, as assignee.

Improvements to leasehold property financed by assignee pursuant to Act 207, Session Laws of Hawaii 2011 and Section 171-36, Hawaii Revised Statutes at a cost in excess of \$60,000.00.

In order for the assignee to amortize this expenditure, assignee is requesting an extension of General Lease No. S-3591 of 10 years, commencing on January 16, 2016 and expiring on January 15, 2026 for an aggregate term of 65 years (initial 55 year term plus the 10 year extension).

LEGAL REFERENCE:

Section 171-36, Hawaii Revised Statutes, as amended.
Act 207, Session Laws of Hawaii 2011.

LOCATION:

Portion of Government (Crown) lands of Kanoelehua Industrial Lots situated at Waiakea, South Hilo, Hawaii, identified by Tax Map Key: (3) 2-2-049:017, as shown on the attached map labeled Exhibit A.

AREA:

15,438 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 produce exchange in character, with prior written consent of the Board.

TERM OF LEASE:

Term of 55 years, commencing on January 16, 1961 and expiring on January 15, 2016.

Request for extension of 10 years commencing on January 16, 2016 and expiring on January 15, 2026.

ANNUAL RENTAL:

Current rent is \$16,680.00, due in semi-annual installments of \$8,340.00 on January 16th and July 16th of each year.

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 January 16, 2011, therefore, staff is recommending the rent for the extended term be determined by an appraisal that will project the rent for the extension period of January 16, 2016 through January 15, 2026. The appraiser shall be selected by the State and paid for by assignee.

CONSIDERATION:

The Assignee paid a nominal consideration of ten dollars and all fees associated with the transfer.

RECOMMENDED PREMIUM:

Not applicable as the lease does not allow for a premium.

PROPOSED IMPROVEMENTS:

Jieyu Shepard, the assignee, proposes to replace the roof and add ventilation, skylights (passive solar), and gutters. The cost of the roof replacement and addition of ventilation, skylights and gutters is estimated to be \$63,750.00.

DCCA VERIFICATION:

Assignor: Vetpro, Inc.

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>

Assignee: Jieyu Shepard

As a sole proprietor, applicant is not required to register with DCCA.

ASSIGNEE REQUIREMENTS:

Assignee shall be required to pay for an appraisal of the projected rent payable during the 10-year extension, from January 16, 2016 to January 15, 2026¹.

Assignee will be required to complete and provide receipts for payment of proposed roof improvements to Land Division staff prior to September 30, 2016.

REMARKS:

General Lease No. S-3591 (GLS-3591) was issued to Isamu Kanekuni and George T. Inouye, Partners, dba Veterans' Produce Exchange on January 16, 1961 by direct negotiation, under the provisions of Act 4, Special Session Laws of 1960, relating to victims of tidal wave disaster.

The lease is for fifty-five years commencing January 16, 1961 and expiring on January 15, 2016. Rental for the first 2 years was waived with a set rental amount of \$560.00 per year for the following 18 years. Rental renegotiations for fair market rent were scheduled for the 20th, 30th, 40th & 50th years of the lease term.

At its meeting of July 23, 1976, agenda item F-1, the Board consented to the assignment of GLS-3591 to Vetpro, Inc. as the corporate successor of the partnership of Isamu Kanekuni and George T. Inouye.

¹ At the Board meeting of June 12, 2015, Item D-2 (regarding an extension request for a different lease), the Board directed staff to request an opinion from the Department of the Attorney General as to: (i) who should bear the cost of the appraisal report, (ii) whether there is an option to split the cost between the State and the lessee, and/or (iii) whether the Board has discretion to determine who bears the cost. Accordingly, staff is including a recommendation below that the appraisal report for the extension period be held in abeyance until the Department of the Attorney General has made findings on opinion request.

By way of lease amendment dated March 03, 1983 and approved by the Board at its meeting of August 27, 1982, agenda item F-2, GL S-3591 was amended to postpone the 1st scheduled renegotiation of rent until the 21st year due to an adverse economic climate.

ASSIGNMENT REMARKS:

Vetpro, Inc. ceased active use of the property at the end of 2012 and in March 2013 began subleasing to the assignee, Jieyu Shepard, who holds the adjacent General Lease No. S-3603. Ms. Shepard's business was expanding and she needed the additional warehouse space for her increasing inventory demands.

Vetpro, Inc. is not interested in continuing its tenancy of the property and has assigned GLS-3591 to Ms. Shepard for nominal consideration as the improvements on the property are aged and will transfer to the State upon expiration of the lease in January 2016.

Ms. Shepard is a successful business woman who has managed to grow her kitchen and bath fixture store during trying economic times. The business has a good reputation and is expanding in scope of product lines (i.e., cabinets, flooring, custom tubs & showers).

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 potentially inconsistent with the use restriction in the lease.² 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 produce exchange in character,³ 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.”

² Although the use restriction in the lease only applied to the first five years of the lease, it is unclear what the allowed use was intended to be after the first five years. Amending the character of use provision will resolve this ambiguity.

³ At the time the lease was issued, local grocery stores and restaurants utilized produce wholesalers to obtain fresh fruits and vegetables. With the appearance of “big box” stores, which ship produce in through their own internal channels, and local “farmers markets”, which provide farm to table fresh products, the demand for wholesalers has been drastically reduced.

In March 2013, as the Lessee was winding down its operations, the Lessee began subleasing a portion of the subject property to the Assignee for her business inventory warehouse purposes. The lease does not require Board consent to sublease a portion of the property so Land Division was not aware of the sublease arrangement. When the assignment was proposed it became apparent that the Assignee's use of the property was not consistent with the character of use within the lease document, potentially creating a non-compliance issue. As explained above, Assignee desires to acquire this lease as additional warehouse space for the increasing inventory demands of her kitchen and bath fixture store. To resolve the potential non-compliance issue, staff is recommending a change in the character of use from "produce exchange" to "uses allowed under the County of Hawaii zoning code, ML-20, limited industrial" making the character of use provision consistent with other State lease properties in the area.⁴

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.

EXTENSION REMARKS:

The assignee has already spent approximately \$15,522 in repairs to the property (new perimeter fencing, addition of a mezzanine and fumigation). She is proposing to replace the roof and add ventilation, skylights (passive solar), and gutters. The cost of the roof replacement and addition of ventilation, skylights and gutters is estimated to be \$63,750.00 (refer to attached Exhibit B). The assignee is requesting a 10 year extension pursuant to Act 207, Session Laws of Hawaii 2011⁵ to amortize the cost of planned improvements to the property at a cost in excess of \$60,000.00.

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. 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 Kanoelehua. These acts provided the Lessees with an option to purchase the land within

⁴ Changing the character of use should not have an impact on the determination of fair market rent charged under the lease. The appraisal report prepared for the most recent rent reopening in this lease (January 16, 2011) made no adjustment to rent based on the use restriction in the lease.

⁵ 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.

two years. Several businesses exercised this option creating an industrial area of mixed DLNR leases and fee simple properties.

Since the implementation of Act 207, SLH 2011, there have been nine leases within the immediate area of the subject parcel that have been granted ten year extensions, including the adjacent property which is currently leased to the assignee.

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.

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 are 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.

On July 17, 2014, Hussey Appraisal Group Hawaii, assignee consultant, tendered its report regarding the economic life and value of the proposed improvements to the leasehold premises. The report stated the estimated economic life of the improvements is 40 to 55 years or more. The \$63,750 estimated cost of refurbishment translates into an increase in building improvement value of \$8.33 per square foot (\$63,750/7650sf.).

The Lessee and Assignee are in compliance with the terms and conditions of their leases. Jieyu Shepard, the assignee, 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. She is in good standing with regard her current lease rents, insurance and bonds. A recent inspection showed good maintenance of the property and existing structures.

No agency comments were solicited on the request because it involves an assignment, amendment and lease extension; not a new disposition.

RECOMMENDATION:

That the Board:

1. Consent to assignment of General Lease No. S-3591 from Vetpro, Inc., Assignor, to Jieyu Shepard, Assignee, subject to the following:
 - a. The standard terms and conditions of the most current consent to assignment form, 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.
2. Authorize the amendment of General Lease No. S-3591 to change the character of use from “produce exchange” 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.
3. Approve the extension of General Lease No. S-3591 to Jieyu Shepard 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. Jieyu Shepard shall complete the proposed roof improvements as described above and submit to the Hawaii District Land Office copies of receipts verifying payment for the improvements by September 30, 2016, or be subject to cancellation;
- c. At the Board meeting of June 12, 2015, Item D-2 (regarding an extension request for a different lease), the Board directed staff to request an opinion from the Department of the Attorney General as to: (i) who should bear the cost of the initial appraisal report, (ii) whether there is an option to split the cost between the State and the lessee, and/or (iii) whether the Board has discretion to determine who bears the cost. Accordingly, the appraisal report for the extension period shall be held in abeyance until the Department of the Attorney General has made findings on the opinion request, and staff has returned to the Board to report on the same;
- d. Review and approval by the Department of the Attorney General; and
- e. Such other conditions as may be prescribed by the Chairperson which are in the best interests of the State.

Respectfully Submitted,


Candace Martin
Land Agent

APPROVED FOR SUBMITTAL:


Suzanne D. Case, Chairperson

Map showing property lots and owners. Key features include:

- Subject Property:** Lot 17, highlighted in purple, labeled "Subject Property (GL S-3591)".
- Adjacent Owners:**
 - North: State of Hawaii (Lots 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 100).
 - West: State of Hawaii (Lots 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 100).
 - East: State of Hawaii (Lots 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 100).
 - South: State of Hawaii (Lots 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97, 98, 99, 100).

Map includes a scale of 1 inch = 50 feet and a note: "Dropped Parcel: S, S".

**FOR REAL PROPERTY TAXATION PURPOSES
SUBJECT TO CHANGE**

EXHIBIT B

Dennis Delfin Contracting



Makalei Designs

DENNIS DELFIN CONTRACTING

POB 7671

HAWAII, 96720

LIC. #BC-14473

Cell: 808-896-2302 Fax: 808-315-7338

Email: dennis5606@hotmail.com

www.DennisDelfinContracting.com

May 14, 2014

CONSTRUCTION PROPOSAL

JOB:

SHEPARD, JIEYU

Hilo, HI

TYPE OF CONSTRUCTION:

Re-roofing w/ ventilation & gutters/replace some Purlins

PROPOSAL AMOUNT:

\$63,750.20 (tax included)

(Sixty-Three Thousand Seven Hundred Fifty & 20/100 Dollars)

PAYMENT SCHEDULE:

\$38,000.00-To Start

\$25,750.20-Upon Completion

INCLUDES: (Labor & Materials)

- **Demo** Removal of existing roof, bad purlins and materials
- **Disposal** Disposal & haul away of materials safely and properly
- **Roofing & Purlins** Order & install of new metal roofing & Purlins , (ridge caps, screws, gable flashing, Peel & seal, insulation, etc.)
- **Ventilation** Order & install new ventilation systems
- **Gutters** Order & install new seamless gutter system
- **Clean up** Clean area of any debris daily for fall protection safety
- **Warranty** 1 year construction warranty from completion date

NOT INCLUDED:

- Owner to provide all utilities

REFERENCES UPON REQUEST: MAHALOI