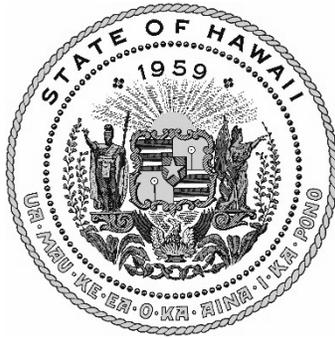


REPORT TO THE THIRTY-SECOND LEGISLATURE
STATE OF HAWAII
2024 REGULAR SESSION

HILO COMMUNITY ECONOMIC DISTRICT



Prepared by

Department of Land and Natural Resources
State of Hawaii

In response to Act 149, Session Laws of Hawaii 2018

November 2023

REPORT TO THE THIRTY-SECOND LEGISLATURE
STATE OF HAWAII
2024 REGULAR SESSION

HILO COMMUNITY ECONOMIC DISTRICT

PURPOSE

Act 149, Session Laws of Hawaii 2018 (Act 149), implemented a 10-year pilot project to allow the Board of Land and Natural Resources (Board) to extend leases in the area of Hilo shown on the attached map for up to 40 years in return for a lessee making substantial improvements to the leasehold premises. “Substantial improvements” is defined in the act to mean renovations or new construction, the cost of which equals or exceeds thirty percent of the market value of the existing improvements. Lessees are required to submit plans and specifications for their proposed development to the Board for approval.

The Board may consider a number of items in determining whether to approve a proposal, including whether the development is of sufficient worth and value to justify an extension, the estimated period of time to complete the improvements, and the minimum revised annual rent based on the fair market value of the land, including percentage rent where gross receipts exceed a specified amount. Any extension granted must relate to the economic life of the substantial improvements as determined by the Board or an independent appraiser. Additionally, an extension cannot exceed the original term of the lease by more than 40 years. The Act imposes on applicants the costs and expenses incurred by the Department of Land and Natural Resources (Department) in processing, analyzing and negotiating any lease extension request and the development agreement.

Act 149 includes a section that ties into existing law at Section 171-41.6, Hawaii Revised Statutes (HRS). This section is a codification of Act 215, Session Laws of Hawaii 2017, that allows lessees within the last 10 years of their leases to follow a detailed process to determine whether they can obtain an extension of their leases even beyond the 65-year maximum limit. Extensions can only be permitted if the lessee is the sole qualified responder to a request for interest/request for qualifications (RFI/RFQ) published by the Board regarding a new lease of the land. If there are multiple qualified responders on the RFI/RFQ, then a new lease of the land is auctioned in the final three years of the term of the current lease. Section 171-41.6, HRS, is limited to commercial and industrial leases, while Act 149 opens up this process to resort leases as well.

PROGRESS ON ACT 149 LEASE EXTENSIONS

Act 149 took effect in July 2018 and was codified at Sections 171-191, -192 and -193, HRS. On September 26, 2018, the Department’s then Chairperson and First Deputy, together with Land Division staff met with lessees, legislators and other concerned persons in Hilo regarding the implementation of the act. Staff explained that any lessee interested in a lease extension would need to submit an application and provide the supporting information required under the law. The Department’s experience with past lease extensions under Section 171-36(b), HRS, and Act 219,

Session Laws of Hawaii 2011, which allowed for the extension of hotel and resort leases, was also discussed.

At its meetings of June 28, 2019, Item D-3, and July 12, 2019, Item D-3, the Board authorized Land Division to negotiate development agreements for two leases under Act 149. The leases were General Lease No. (GL) S-3742 to JH Moku Ola, LLC and GL S-3621 to Crescent City Properties, Inc., respectively. Both leases were originally issued by direct negotiation as opposed to public auction. At its meeting of March 27, 2020, Item D-6, the Board approved the development agreement and lease extension for GL S-3742 to JH Moku Ola, LLC and the lease extension for that lease, incorporating the current lease terms and conditions used by the Department of the Attorney General (ATG), is complete. Crescent City Properties, Inc. later revised its proposal for improvements to the leased premises under GL S-3621, which the Board approved at its meeting of December 9, 2022, Item D-6. The development agreement and lease extension for GL S-3621, also incorporating the ATG's current lease terms and conditions, is now complete.

Subsequent to the Board's actions of June and July 2019, other lessees approached the Department with a request to streamline the Act 149 process so that only one Board action would be required on their development agreements and lease extensions. The Department reviewed the request with the ATG and determined that if the lessees were willing to pay for appraisals to establish rent in the extension period prior to Board action on an Act 149 request, then the rent could be so determined and presented to the Board at the same time as lessee's development agreement. To date, eight lessees have submitted applications for Act 149 extensions under this new process affecting eleven separate leases.

At its meeting of June 12, 2020, Item D-3, the Board authorized the Land Division to negotiate a development agreement and approved a thirty-year extension of lease terms for three leases under the streamlined process – GL S-3592, GL S-3609 and GL S-3611 all to Hawaii Planing Mill, Ltd. (HPM). These leases were also originally issued by direct negotiation. The extensions for these three leases, updated to the ATG standard terms and conditions, are now complete.

At its meeting of July 23, 2021, Item D-1, the Board authorized the Land Division to negotiate a development agreement and approved a thirty-nine-year extension of lease term for GL S-3935 to Alan R. Nagakura and Lori E. Nagakura, Trustees under Irrevocable Trust of Roy S. Nagakura dated March 4, 1996. This lease was originally issued by public auction. Documentation of the development agreement and lease extension is in progress.

At its meeting of February 11, 2022, Item D-2, the Board authorized the Land Division to negotiate a development agreement and approved a thirty-year extension of lease term for GL S-3624 to 69 Railroad, LLC (69 Railroad), which was originally issued pursuant to public auction in 1961. At the time the Board approved the lease extension, it was under the understanding that *Kahua Ranch*¹ precluded the Department from updating the lease to the current standard lease terms used by the ATG in the extension period because it was issued by public auction. The Department therefore

¹ *State v. Kahua Ranch, Ltd.*, 47 Haw. 28, 384 P.2d 581 (1963), aff'd on reh'g, 47 Haw. 466, 390 P.2d 737, reh'g denied, 47 Haw. 485, 391 P.2d 872 (1964).

initially negotiated the development agreement and lease extension with 69 Railroad on that basis. After receiving an advice letter from ATG on July 26, 2022, the Department determined that public auction leases could be updated to the ATG's current lease terms and conditions, to the extent necessary to implement the requirements of Act 149. The Department wrote to 69 Railroad on August 17, 2022 advising it that the Department would take no further action on the development agreement and lease extension until the Department could return to the Board to report on the ATG advice letter.

On September 20, 2022, 69 Railroad filed a lawsuit against the Department and others asserting claims for estoppel and declaratory relief and seeking an order directing the Chairperson to execute the development agreement and lease extension.

At its meeting of September 23, 2022, under agenda Item D-2, the Board approved, as amended, the Department's request to direct that the development agreement and lease extension document for the 69 Railroad lease be updated to the ATG's current lease terms and conditions, to the extent necessary to implement the requirements of Act 149. Specifically, the Department sought the incorporation of the standard terms and conditions regarding lease assignments, sublease rent participation, and ownership of improvements at lease expiration used by ATG with respect to leasing of public Lands. The Board's amendment waived State participation in the sublease rents as to those subtenants and rents to which the Board had previously consented, but as to new subtenants or if the rents from subleases increase by 25% or more, then the Board may elect to participate by receiving a portion of the sublease rents in addition to the base ground rent. 69 Railroad requested a contested case hearing prior to the close of the meeting, which the Board denied.

The 69 Railroad litigation was settled in 2023 and the development agreement and lease extension for the lease, updated with the ATG standard terms and conditions regarding lease assignments, sublease rent participation, and ownership of improvements at lease expiration, are now complete.

Since the last report to the Legislature on Act 149, Land Division has initiated the practice of having the applicants' appraised values of existing leasehold improvements reviewed by an independent appraiser procured by the State to ensure that the values stated in the applications are compliant with the Uniform Standards of Professional Appraisal Practice and meet the statutory threshold to qualify for a lease extension.

At its meeting of September 22, 2023, Item D-4, the Board approved the extension of GL S-4201 to Jennifer Frank, as the Successor Trustee of the Stephen Harold Frank Living Trust dated March 27, 2014, also known as Stephen Harold Frank Revocable Trust. GL S-4201 was issued by public auction and the development agreement and lease extension document will also be updated with the ATG standard terms and conditions regarding lease assignments, sublease rent participation, and ownership of improvements at lease expiration.

In summary, as of October 2, 2023, Land Division has received a total of 13 lease extension applications under Act 149. Eight have received Board approval and five are still under review.² Of the eight extensions that have received Board approval, six are complete and two are in the documentation process.

FINDINGS AND RECOMMENDATIONS FOR PROPOSED LEGISLATION

Based on applications received and continuing communication with its lessees, the Department finds there is significant interest among its Hilo lessees in securing lease extensions pursuant to Act 149. The Department will continue to present lease extension requests to the Board for consideration and process approved extensions as long as the applicants agree to the updating of the development agreement and lease to the current terms and conditions used by the ATG, to the extent necessary to implement the requirements of Act 149.

In 2021, the Legislature passed House Bill 499, House Draft 2, Senate Draft 2, Conference Draft 1, which later became law as Act 236 Session Laws of Hawaii 2021 (Act 236). Similar to Act 149, Act 236 authorizes the Board to extend commercial, industrial, resort, as well as mixed-use and government leases, up to 40 years upon lessee committing to substantial improvements to existing buildings and infrastructure on the lease premises. Act 236 has statewide application.

At the end of the 2021 Session, the House of Representatives adopted House Resolution No. 164 establishing a House Investigative Committee (Investigative Committee) to follow up on the audit of the Department's Special Land and Development Fund, Report No. 19-12, to examine the recommendations made in the audit for purposes of improvement of the operations and management of the Department, its funds, and any other matters.³ After conducting numerous interviews and public hearings, the Investigative Committee published its Final Report on January 29, 2022. The report includes the following recommendations:

- (2) The Legislature should regularize and make consistent the various lease extension statutory language in Chapter 171, HRS. The Legislature should also amend the lease extension laws to specifically:
 - (A) Allow all types of leases to be extended, but require that all lease extensions, regardless of whether those leases were obtained through direct negotiation or the public auction process, use the most current lease form and leasing practices and policies, including provisions to allow the State to be paid its fair share of sublease income;
 - (B) Allow the State to charge rent premiums on extended leases to compensate the State for forgoing the reversionary interest and incorporate the value of the improvements on the property; and

² In some cases where applications are still under review, the lessees have sublessees on the premises whose tenancies have not been consented to by the Board. These sublease issues have to be sorted out before the lease extension requests can be presented to the Board.

³ The resolution also provided for follow-up on Audit Report No. 21-01 regarding the Agribusiness Development Corporation.

- (C) Require a lessee to pay for the appraisal required for the reopening of rent in the extended lease term and preclude the lessee from protesting the rent so determined; . . .

- (5) DLNR should require third-party inspectors to conduct physical inspections of all leased properties every five years to ensure compliance with lease terms. DLNR should choose the inspectors and require the lessee to pay the inspection fee and make the corrections recommended in the inspection report; . . .

Regarding recommendation 2(A) above, the Department intends to introduce a bill in the 2024 Session that would require all leases to be updated to the current lease form and leasing practices used by the Department when the Board approves an extension of a lease. The Department has not yet proposed a bill to implement recommendation 2(B), which proposes rent premiums and rent based on land and improvements when a lease is extended. With respect to recommendation 2(C), both Act 149 and Act 236 require the lessee to pay the costs of the extension, including the appraisal required to determine fair market rent in the extension period, however neither act precludes the lessee from protesting the rent so determined. Finally, the Department intends to introduce a bill in the 2024 Session to implement recommendation 5 above relating to periodic third-party inspections of leased properties to be paid for by lessees.



Hilo Community Economic District under Act 149, Session Laws of Hawaii 2018

(Area within yellow border)