

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
Division of Forestry and Wildlife
Honolulu, Hawaii 96813

September 25, 2009

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

Land Board Members:

SUBJECT: Amendment No. 2 of Timber Land License No. 2007-H-01 held by Hawaii
Island Hardwoods, LLC.

Background: At its June 22, 2007 meeting under item C-2, the Board approved issuance of a Timber Land License to Hawaii Island Hardwoods, LLC (HIH) for timber resources within the Waiakea Timber Management Area (WTMA) on Hawaii island, in support of HIH establishing a state-of-the-art, medium sized sawmill facility. Timber Land License No. 2007-H-01 (“License”), was fully executed on September 10, 2007.

License terms included details for four (4) phases of development (see copy of License Table 2 below), a condition that harvesting within the licensed WTMA timber stands be initiated within 28 calendar days of License execution, specifications for mill size/capacity and others. HIH initiated harvesting within the designated time frame during the period of October to December 2007, but has not conducted harvest operations in the License area since that time.

Table 2. Licensee sawmill development schedule.

Item	Phase	Time Period
Traveling carriage head saw	II	6-12 months
Band or circle head saw	II	6-12 months
Dry kiln capacity to accommodate 1,000,000 BF/yr	II	6-12 months
Sorting line	III	9-18 months
Stacking machine	III	9-18 months
Planer	III	9-18 months
Two-saw, dual laser board edger	IV	12-48 months
Dry kiln capacity to accommodate 5,000,000 BF/yr	IV	12-48 months

The Department considered and approved this License for many objectives, some of which included: Promotion of local forest industry processing to provide products for the Hawaii Market; providing a steady revenue stream to the Department; and fostering the establishment of

a state-of-the-art sawmill with considerably larger processing capacity than any other existing operation in the State.

Upon request from HIH and approval of the Board, the License was amended on December 10, 2008, by extending all of the deadlines in Table 2, as depicted above, for Phases II and III to 24 months. In two additional letters dated July 23, 2009, and September 15, 2009, HIH has provided DOFAW with additional information regarding their business progress to date, and requested further amendments to the License (Exhibits A&B). HIH is currently requesting two principal amendments to the License. The first would amend License Table 2 by further extending the deadlines for Phases II & III for one (1) additional year to 36 months. The proposed amended table is set forth below. The second amendment would be to decrease the amount of the bond obligation from \$250,000 to \$50,000.

Table 2. Licensee sawmill development schedule (amended).

Item	Phase	Time Period
Traveling carriage head saw	II	6-36 months
Band or circle head saw	II	6-36 months
Dry kiln capacity to accommodate 1,000,000 BF/yr	II	6-36 months
Sorting line	III	9-36 months
Stacking machine	III	9-36 months
Planer	III	9-36 months
Two-saw, dual laser board edger	IV	12-48 months
Dry kiln capacity to accommodate 5,000,000 BF/yr	IV	12-48 months

Discussion: Results to date have been mixed. Though harvesting was initiated immediately after License execution in September 2007, there has not been a subsequent stream of harvesting and associated revenue generation for the Department since approximately February 2008. HIH indicates a plan to re-initiate harvesting in the License area during 2009. HIH has incrementally increased their mill equipment inventory and mill capacity, secured a prospective site for new mill construction, but has not met extended deadlines for Phase II, Phase III or overall milling capacity. None the less, as detailed in their latest letter, HIH is operational, has recorded growth in gross receipts, marketing and sales efforts, and is supplying product to the Hawaii market while providing local employment opportunities.

Despite the fact that HIH is exhibiting growth during a significant economic recession, it appears that the original mill development schedule proposed by HIH and incorporated into the License was too ambitious - HIH needed more time to establish markets for their wood products in Hawaii and elsewhere. At the same time, it appears likely that the HIH mill and it's associated processing capacity will continue to grow incrementally over the next few years. Staff suggests

continued partnership between the Department and HIH by amending their License to allow one (1) additional year of mill development. This would be accomplished by extending the time period for all Phase II & III items in Table 2 from 24 to 36 months.

Staff notes that such a request also necessitates an amendment to License Section 10.17 whereby the deadline within which HIH would be obligated to have a mill with a 1,000,000 annual board foot processing capacity would also need to be extended to 36 months.

Regarding the request by HIH that the License bond obligation be reduced from \$250,000 to \$50,000, Staff is in agreement with the added condition that HIH be authorized to conduct harvesting operations on a maximum of 40 acres at any given time, with a harvest area closeout audit by DOFAW required prior to HIH proceeding to additional harvest areas.

Staff notes that relating to road maintenance, License Section 5.3 specifies that DOFAW was to be responsible for maintaining/upgrading one (1) road within the License area by this time. The Division has not met this responsibility nor initiated this work due to the dormant state of HIH's field operations in the License area. Staff recommends amending Section 5.3 whereby DOFAW's maintenance and upgrade activities for this road be tied to a 180 day written notice from HIH regarding their intent to harvest in the affected and adjacent timber stands. If DOFAW decides, in its sole and absolute discretion that it is unwilling or unable to perform the maintenance and upgrading of that one (1) road mentioned above, then; (a) HIH will be notified of the same in writing within thirty (30) days of the Department receiving HIH's intent to harvest notification; (b) HIH shall become responsible for maintenance and upgrade work for the aforementioned road segment; and (c) as compensation, the stumpage pricing basis paid by HIH to the Department for timber harvested from the three (3) adjacent timber stands accessed by this road shall be reduced by 33%.

RECOMMENDATIONS:


1. That the Board of Land and Natural Resources amend Timber Land License No. 2007-H-01 held by Hawaii Island Hardwoods, LLC by:
 - a. Extending the deadlines for all Phase II and Phase III items in Table 2 to thirty-six (36) months;
 - b. Extending the deadline in section 10.17 for HIH to establish a mill with a 1,000,000 annual board foot capacity to 36 months;

- c. Reducing the amount of the performance bond from \$250,000 to \$50,000 with new harvest unit size limitations and audit terms as detailed above; and
- d. Revising section 5.3 to require DOFAW to maintain or upgrade the road only upon receipt of a 180 day written notice from HIH regarding its intent to harvest in the affected area and adjacent timber stands. If DOFAW decides, in its sole and absolute discretion that it is unwilling or unable to perform the maintenance and upgrading of that one (1) road mentioned above, then; (a) HIH will be notified of the same in writing within thirty (30) days of the Department receiving HHV's intent to harvest notification; (b) HIH shall become responsible for maintenance and upgrade work for the aforementioned road segment; and (c) as compensation, the stumpage pricing basis paid by HIH to the Department for timber harvested from the three (3) adjacent timber stands accessed by this road shall be reduced by 33%.


2. That the amendment of the License be subject to:

- a. Review and approval by the Department of the Attorney General; and
- b. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.

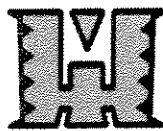
Respectfully submitted,


for PAUL J. CONRY, Administrator
Division of Forestry and Wildlife

APPROVED FOR SUBMITTAL:


LAURA H. THIELEN, Chairperson
Board of Land and Natural Resources

Exhibits A&B



Hawaii Island Hardwoods LLC

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<http://www.hawaiiislandhardwoods.com>

July 23, 2009

Paul J. Conry
Department of Land and Natural Resources
Kalanimoku Building
1151 Punchbowl St
Honolulu, HI 96813

Subject: Hawaii Island Hardwoods Status Report

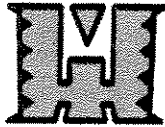
Dear Paul,

I am writing to update you and the Board of Land and Natural Resources regarding our license for timber harvesting on the Waiakea Timber Management Area (#2007-H-01). We applied for an extension last year due to issues of marketing and capital investment. Since that time we have experienced both positive and negative events in the economy and in the development of our processing site.

Hawaii Island Hardwoods LLC (HIH) expected to be selling Robusta, Saligna, Toon and Alder at a fairly significant rate through targeted allies and partners. We logged about 70,000 board feet from the Waiakea in 2007. There was some success early on but in 2008 the world wood business went into a tail spin. The Hawaii market held up for awhile but the ultimate result was the entry of significant players from the mainland and abroad bidding on jobs at rates below those that our affiliates could compete with.

We have, however, refocused our efforts (essentially starting all over again) and we are now experiencing significant increases in sales volumes and sales realizations on an ever widening mix of products and timber species. Our gross sales increased from \$240,000 to \$435,000 from 2007 to 2008. We have been introducing a variety of species and product finishes in an engineered flooring line that is currently being produced for us in California. Locally grown woods are featured on the surface with a plywood substrate. Nepal Alder from the WTMA has been installed at Pictures Plus on Maui. Eucalyptus Saligna from DLNR Hoesa tract on the Hamakua Coast is being used in engineered flooring at Pictures Plus in the Ward Center and in a home in Kona.

We have several exterior decking projects using Eucalyptus Robusta. One of these projects is coupled with products from the Waiakea Timber Management Area (WTMA). It includes Toona Ciliata posts and rails.



Hawaii Island Hardwoods INC

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We had to place our future mill design on hold due to the tough economy, weak markets, absence of sufficient electric power and difficulties in raising capital. We continue to have logs and lumber in inventory from our first round of logging in the Waiakea. Our enlarged mill would be idle in this market.

We anticipated that our site at Kea'au would be able to be connected to three (3) phase 440 volt electricity from the transmission lines running past us on the opposite side of Kea'au - Pahoa Road. We were assured by Helco that there was sufficient power capacity on the lines but then we learned that we could not access that power without an environmental assessment due to chapter 343. We are in the process of starting up a planer, a rip saw and chop saw at Pepe'ekeo on temporary 3 phase, 440 volt power. We are also in the process of determining if an Act, recently signed by the governor, will allow us to get an exemption from Chapter 343 and allow us to proceed with connecting 3 phase power at Kea'au.

In spite of all the constraints, HIH continues to employ three people full time plus three to six contractors on an on-going basis. Some of the products which came from our first round of logging on the Waiakea have also received additional processing at other operations on Hawaii Island and on Oahu. Some have been shipped to Oregon as we attempt to penetrate the mainland market also. (After all, one good turn deserves another – doesn't it?)

We hope to do another round of logging in the WTMA this fall with a focus on trials on the Eucalyptus Saligna/Grandis and Queensland Maple. We may also have need of additional Toona Ciliata and Nepal Alder within the next six (6) to nine (9) months. We are concerned that the E. Saligna/Grandis in the WTMA may be of lighter color and lesser hardness than the E. Saligna that we acquired from DLNR in the Hoesa tract on the Hamakua Coast. It is important for us to determine what the market potential of this species is likely to be.

We believe that no one else since Capitol Chips has bought more timber from the State than has Hawaii Island Hardwoods. We also believe that our market development is far beyond any others in both volume and complexity. We will be booking over \$100,000 in sales in July and we expect our annual sales to continue to exceed the prior year's sales by a significant percentage.

We recommend our web site <http://www.hawaiiislandhardwoods.com> for a more extensive review of our product lines and strategies.



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We have been informed that the timing is such that we should be appearing before the Board on August 28th. I, however, will be en route to New York and Europe on the 28th with a return on September 20th. We, therefore, would like to request a postponement of our appearance until late September or October.

License Agreement between DLNR and HIH

**Request for Amendments:
Timber Land License Number 2007-H-01
Effective date September 10, 2007**

We are requesting a one year extension upon all terms in the original and amended license.
We are also requesting a reduction in the bonding requirement on this license from \$250,000 to \$50,000.

Respectfully submitted:

James E. Quinn
Member Manager



Hawaii Island Hardwoods LLC

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September 16, 2009

Michael Constantinides
Department of Land and Natural Resources
State of Hawaii

Dear Michael:

This letter is to supplement our recent letter to Paul Conry regarding the Hawaii Island Hardwoods LLC (HIH) license for timber harvest in the Waiakea Timber Management Area (WTMA). In that letter we described our progress at improving the marketing of Hawaiian grown wood species. We also listed numerous constraints in the marketplace and in logistics and services in Hawaii. We requested extensions on our license and a reduction in the bonding required for timber harvesting activities. As mentioned in that letter, this is a difficult period in which to raise investment capital and to sell products into a sluggish economy.

There are, however, opportunities that we foresee in the next two years for logging activity in the WTMA that would match with developing market potential. We hope to have a value adding operation up and running during 2010. This will include a planer, rip saw and moulder. We also hope to add one or two additional dry kilns. Our current solar/gas kiln has proved out well and it is delivering very good quality kiln dried lumber. In late 2010 or early 2011 we hope to have some additional saw milling capacity in operation but it may not be the type that was originally planned.

Following are rough estimates in board feet (bf) of what we believe may be potential harvest amounts in 2009, 2010 and 2011 if marketing activities and product demand continue to improve. We are hopeful that demand and harvest will double again in 2012.

<u>Species</u>	<u>Year</u>	<u>Quantity</u> Bf	<u>Year</u>	<u>Quantity</u> bf	<u>Year</u>	<u>Quantity</u> bf
• Toona Ciliata			2010	10,000	2011	20,000
• Nepal Alder			2010	5,000	2011	15,000
• E. Saligna/Grandis	2009	5,000	2010	5,000	2011	10,000
• Eucalyptus Robusta			2010	10,000	2011	20,000
• Queensland Maple	2009	<u>5,000</u>	2010	<u>10,000</u>	2011	<u>15,000</u>
Estimated totals:	2009	10,000	2010 -	40,000	2011	80,000

Respectfully submitted:

James E. Quinn,

Member Manager, Hawaii Island Hardwoods LLC