

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

December 11, 2009

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

MAUI

Applicant's Request for Mutual Cancellation of General Lease No. S-4212 and Revocable Permit No. 7235 to Western Apartment Supply & Maintenance Co., dba Maui Oceanfront Inn, and Sale at Public Auction of Two Co-Terminus 55-Year Leases, Kihei, Maui, Hawaii, Tax Map Keys (2) 3-9-004:029 and 149

APPLICANT:

Western Apartment Supply & Maintenance Co., dba Maui Oceanfront Inn, a California corporation whose mailing address is 1335 Hotel Circle South, San Diego, California 92108.

LEGAL REFERENCE:

Section 171-61, Hawaii Revised Statutes, as amended.

LOCATION:

Portion of Government lands situate on the west side of Piilani Highway, Kamaole, Wailuku, Maui, identified by Tax Map Keys (2) 3-9-004:029 and 149, as shown on the attached map labeled Exhibit A.

AREA:

Parcel 29	1.119 acres, more or less
Parcel 149	0.698 acres, more or less

ZONING:

State Land Use District:

Parcels 29	Urban
Parcel 149	Urban

County of Maui CZO:

Parcel 29	H-M Hotel District
Parcel 149	Park (Pending a Conditional Use Permit Application to Allow Parking for Public Beach Access)

TRUST LAND STATUS:

Section 5(b) lands of the Hawaii Admission Act

DHHL 30% entitlement lands pursuant to the Hawaii State Constitution: Yes ___ No X

CURRENT USE STATUS:

- Parcel 29 Encumbered by General Lease No. S-4212 ("Lease") to the Applicant for apartment-motel cottages and accessory use purposes. "Accessory" uses shall include a restaurant-bar and other service facilities.
- Parcel 149 Encumbered by Revocable Permit No. 7235 ("Permit") to the Applicant for parking lot purposes.

CHARACTER OF USE:

- Parcel 29 Apartment-motel cottages and accessory use purposes. "Accessory" uses shall include a restaurant-bar and other service facilities.
- Parcel 149 Parking lot purposes.

LEASE TERM:

The Lease encumbers Parcel 29 for a term of 65 years commencing September 4, 1968 expiring September 3, 2033. The last rental reopening occurred on September 4, 2003 and the next rental reopening will occur on September 4, 2013. Rent is currently \$87,739.20 per year.

The Permit encumbers Parcel 149 on a month-to-month basis commencing December 1, 2000. Rent is currently \$127.00 per month, an amount equal to \$1,524.00 per year.

CHAPTER 343 - ENVIRONMENTAL ASSESSMENT:

In accordance with the "Division of Land Management's Environmental Impact Statement Exemption List", approved by the Environmental Council and dated April 28, 1986, the subject request is exempt from the preparation of an environmental assessment pursuant to Exemption Class No.1, that states "Operations, repairs or maintenance of existing structures, facilities, equipment or topographical features, involving negligible or no expansion or change of use beyond that previously existing."

DCCA VERIFICATION:

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

BACKGROUND:

The Land Board at its meeting on March 22, 1968, under Agenda Item F-8, approved a 65-year lease by public auction to Walter Witte and John Fagan for apartment-motel cottages and accessory uses that include a restaurant-bar and other service facilities. On subsequent multiple occasions, the Lease was assigned to various parties as approved by the Land Board. The Lease encumbers Parcel 29.

The Land Board at its meeting on May 12, 2000, under Agenda Item D-11, approved the assignment of the Lease from Towa Shinyo Maui, Inc. to the Applicant and simultaneously consented to the Applicant's assumption of a first mortgage with Central Pacific Bank, having a remaining balance of about \$3.5 million and a seller carry-back second mortgage of \$615,000.

The Land Board at its meeting on May 12, 2000, under Agenda Item D-12, approved a revocable permit to the Applicant for parking lot purposes. This Permit encumbers Parcel 149.

On March 14, 2001, the Applicant obtained a first mortgage for \$7.6 million from La Jolla Loans. Loan proceeds were used in the following manner: \$6.0 million to pay off existing debt incurred for the purchase of the hotel and its construction, \$600,000 to pay off a loan also for construction purposes, and \$1.0 million for operating funds.

In 2004 and again in 2007, the Applicant was under U.S. Bankruptcy Court for the District of Hawaii (Chapter 11) protection; both bankruptcy cases were subsequently dismissed.

The Land Board, at its meeting on February 9, 2007, under Agenda Item D-8, approved the consent of a Financing Agreement and Estoppel Certificate. The security agreement between the Applicant and La Jolla Bank ("Lender"), was for an amount not to exceed \$12.5 million. The purpose of the loan was to allow the Applicant to pay off its existing mortgage and to pay off its secured and unsecured creditors as previously approved by the Bankruptcy Court on January 29, 2007. Loan proceeds were used in the following manner: \$10.0 million to pay off existing debt and the balance to pay for taxes and encumbrances including the balance of the security deposit due to the Department of Land and Natural Resources for the Lease. Excess loan proceeds were held in a line of credit.

In March 2009, Mr. Jonathan Durrett, attorney for the Applicant submitted an Application for a mutual cancellation of the Lease and the Permit. The Application also seeks the award of two new 55-year leases for the hotel and parking lot sites by public auction pursuant to Section 171-61, Hawaii Revised Statutes ("HRS").

HRS Section 171-61 provides, in part, that:

"Whenever land or a portion thereof under lease can be re-leased or sold for a higher and better use, or for the existing use to a greater economic benefit to the State, the board, subject to the consent of the lessee, the lessee's successors, or assigns, and each holder of record having a security interest, may cancel the lease without compensation to the lessee or withdraw a portion of the land from the lease and re-lease or sell the same;"

The Applicant claims approving the Application would result in greater economic benefit to the State by its efforts to correct land use violations, preserving 100 jobs, increasing revenue and taxes, and ensuring orderly development of the Kihei Shoreline Area.

According to the Application, urgent debt restructuring of the property is imperative to the hotel's short-term survival and long-term performance under its Lease. It further states the property has been operating at a loss from before June 2008 to the present, and based on present occupancy trends and revenue forecasts, the Applicant will likely default on its loans and exhaust available cash reserves by the end of the second quarter of 2009 eventually resulting in employee layoffs and the cessation of operations. Therefore, the Applicant is seeking to restructure its existing debt with a new \$14.0 million loan from the Lender. See attached letter labeled Exhibit B. The Applicant intends to refinance the existing debt with a 15-year loan that would amortize over 30 years. A balloon payment, estimated by the Applicant at \$10.1 million, would be due at the end of the 15 years. The Applicant then intends to again refinance the balloon payment.

Multiple land use violations exist on the property involving shoreline setbacks, improvements within the setback area, and structures located on the adjacent State Beach Reserve as shown on the attached map labeled Exhibit C. In November 2005, the Applicant was named as an Interested Party in a Settlement Agreement with Maui County to correct the variances. In its Application, Applicant states it will satisfy all requirements of the Maui County Settlement Agreement by the fourth quarter of 2009.

Currently, the Applicant is in default of its Lease with a rent delinquency approaching ninety (90) days. On October 15, 2009, staff issued a Notice of Default to the Applicant for \$43,869 representing the semi-annual rent due for September 4, 2009 through March 3, 2010. Fire and liability insurance are both current and expire on February 14, 2010 and February 28, 2010, respectively. The Applicant has not had a lease, permit, easement or other disposition of State lands terminated within the last five (5) years due to non-compliance with such terms and conditions.

ANALYSIS:

The subject properties are prime oceanfront properties located in Kihei, which is immediately adjacent and north of the Wailea Resort area, and the Makena Beach and Golf Resort, whose properties span 1,500 acres and 1,800 acres, respectively. These resort properties include multiple world-class hotels, luxurious condominiums and villas, well-appointed private homes, pristine beaches and renowned golf courses. The Grand Wailea recently completed \$50 million in renovations. Tying up two prime and developable properties for 55 years would eliminate the State's ability to maximize the property's highest and best use upon expiration of the existing Lease in 2033. The subject properties are also adjacent to, or near, other Kihei resort and/or condominium developments.

Staff believes that tying up the subject properties for 55 years would not be in the best interest of the State. In particular, a 55-year lease for Parcel 149 that limits the use to parking would not be the highest and best use of the property. Parcel 149 currently generates lease rents of only \$1,524 per year and is an interim temporary use for the duration of the Permit. Parking was not intended to be a long-term use of the property.

The Applicant does not intend to make any substantial improvements to the property, or do anything to reposition the hotel in a manner that would increase revenues. The primary, if not the sole purpose of the request, is to refinance existing debt.

Staff inquired if a 30-year lease term would be acceptable to the Applicant. Mr. Durrett said the lease term was non-negotiable because of (1) refinancing the balloon payment at the end of 15 years will require at least an additional 30 years remaining on the new leases, and (2) Lender's loan-to-value ratio requirements. It appears the Applicant's request for new leases is solely to improve the Applicant's cash flow by refinancing existing debt over a longer term to reduce its loan payments¹. The Applicant is seeking immediate financial relief to alleviate operating costs. The entity in the best position to assist the Applicant's cash flow position is the Lender. The Lender not only has the ability to defer payments or restructure the loan, it also has the added incentive of avoiding having a real estate owned asset in its portfolio, let alone a non-performing one.

There is a mortgage lender securing the leasehold interest and staff does not believe the Lender would walk away from the property. Similar to other financially troubled hotels Statewide, as seen in September 2009 with the Maui Prince Hotel in the Makena Beach and Golf Resort, Lenders have stepped in to take over the property and ultimately find a hotel operator. While some instances may have resulted in a temporary closure of operations for a short while and perhaps some lay offs, ultimately, the troubled hotels are continuing to operate and many employees retained their jobs.

According to Mr. Durrett, the Applicant intends to seek a buyer for the property with the enhanced value created by the longer-term leases. Two new 55-year leases would enhance the marketability and value of the subject property's leasehold interest, which is intended to be used as collateral to refinance existing debt, but drastically limits the State's future use and returns on the properties. The Applicant does not intend to use any of the new money to improve the property and this request appears to revolve around a cycle of refinancing to keep operations afloat until the Applicant can sell

¹ Any perceived savings may be speculative due to the floating monthly interest rate. See attached Exhibit B.

the property.

Based on the Application, and information provided, staff does not believe Applicant's proposal meets the statutory requirements of HRS Section 171-61, i.e., does provide a greater economic benefit to the State. On the contrary, it would only serve to increase the value of the Lessee's estate to the detriment of the State².

RECOMMENDATION: That the Board:

Deny Applicant's request for the mutual cancellation of General Lease No. S-4212 and Revocable Permit No. 7235 and the sale of two co-terminus 55-year leases at public auction.

Respectfully Submitted,



Morris M. Atta
Administrator

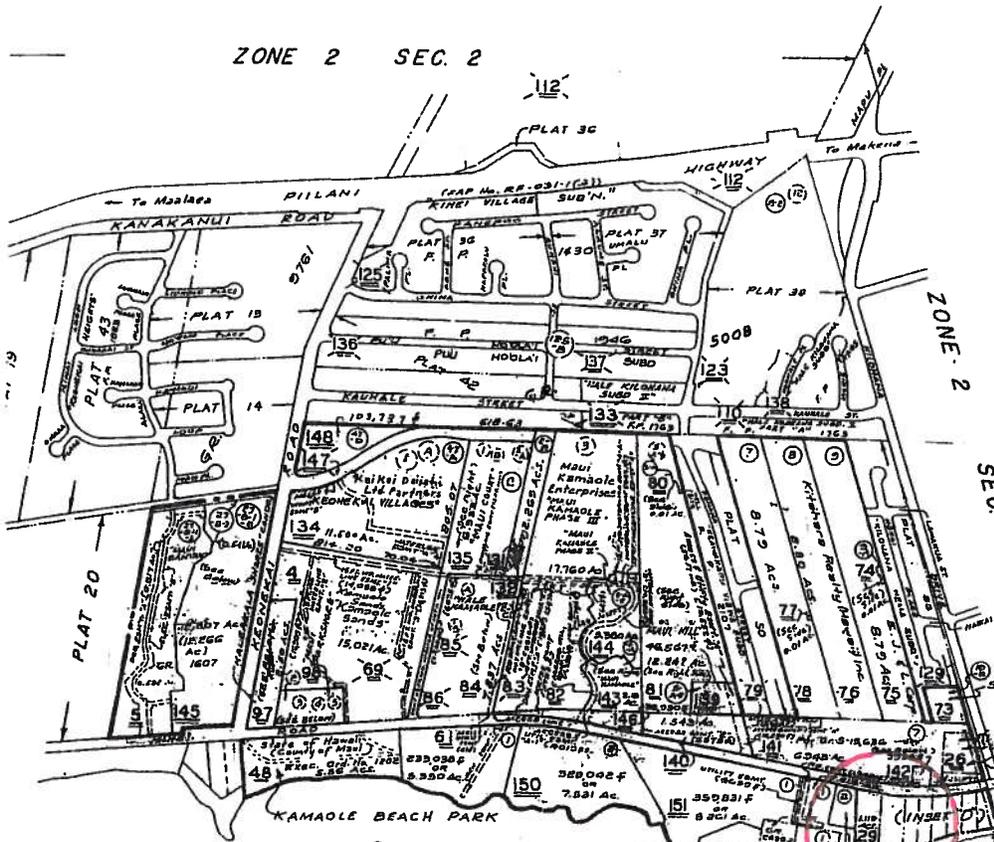
APPROVED FOR SUBMITTAL:


Laura H. Thielen, Chairperson

² If the Land Board authorizes the issuance of new 55-year leases, staff recommends any new lease include the Board's Assignment of Lease Evaluation Policy. Furthermore, staff recommends the Board specifically provide for no waiver of the policy in the future. This would ensure the new leases are not for speculative purposes.

TRUE NORTH
Scale: 1 in. = 500 ft.

ZONE 2 SEC. 2



74 Ltd. 54%
Trust - 23%
Trust 23%
on St Paul Deville

SEC. 2
My (Hawaii) Inc. - 1/4
Kamaole Beach
City (Hawaii) Inc
see TMB 1926 '67

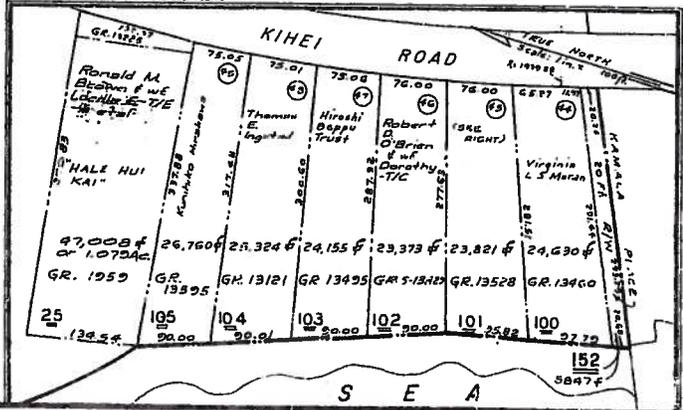
NOTE

24, 34, 36, 37, 38, 39, 40, 41, 42
91, 94, 95, 111, 113, 115, 116, 117, 118
dropped into Plat 3-D-17
20, 51, 59, 60, 65, 66, 67, 70, 99
"MAN 128" dropped into Plat 3-D-1
62, 124 & 127 dropped into
19.
1, 22, 32, 52, 53, 54, 55, 56, 5,
106, 107, 108, 114, 120 & 122
Plat 3-D-20.
dropped into Plat 3-D-09
1 into 3-D-05-52.
into 3-D-12-31.
into 3-D-16-1
2 into 3-D-13 & 14
4 into 3-D-12-1, etc

Maui Banyan Ltd. Partnership 98
of Hawaii Enterprises (Kamaole Enterprises Corp.) sub-ls
Kamaole Enterprises I) sub-sub-ls
Kamaole Shares Development Co
Maui Corporation

99 Maui Parkshore Associates 77,880 sq ft
140 State of Hawaii (Kamaole Beach Park) sub-ls
Rev. Pmt. 5-5200 over 0.538 Ac
(Maui Hill Condominiums) sub-ls
Rev. Pmt. 5-5775 over 1205 Ac
84 "Hale Kamaole" Honolulu Federal Savings & Loan Association

29 State of Hawaii (Island Investment Ltd) in G.L. 5-3212 (Tawa Shinyo Hawaii Inc) sub-ls
28 "K.hei Sunrise" Seaside Development



141 George P. Ferris Eleanor B-T/B
142 State of Hawaii (County of Maui) "SEWAGE PUMP STATION" Dec. Ord 3280
101 Jessie C. Dwyer, Lucile D. Anderson, Cheryl E. Anderson, James D. Anderson, Alexander W. Anderson, Lindis A. Anderson, Albert E. Anderson
26 Robert C. Seeley, William A. Seeley, C. Colwell, Edward A. Colwell & K. Heke
1 Share of Hawaii

DEPARTMENT OF THE TAX COMMISSIONER		
TAXATION MAPS BUREAU		
STATE OF HAWAII		
TAX MAP		
SECOND	DIVISION	
ZONE	SEC.	PLAT
3	9	04
CONTAINING		PARCELS
SCALE: 1 IN. = 500 FT.		

EXHIBIT A

La Jolla Bank, F.S.B.

February 17, 2009

Mr. Carroll Davis, President
Western Apartment Supply & Maintenance Co.
1335 Hotel Circle South
San Diego, California 92108

RE: Mortgage Refinancing for the Maui Oceanfront Inn, Maui, Hawaii

Dear Mr. Davis:

La Jolla Bank (hereinafter the "Bank") has been requested by you to review a possible Loan Request for the above referenced project. The Bank is willing to proceed with further review of your application in accordance with the application terms outlined below.

This letter does not constitute a loan commitment or conditional loan approval. It is the intent of this letter to provide all parties with a written understanding of the terms and conditions under which the loan request will be reviewed by the Bank's Loan Committee.

It is further understood by the Bank that this loan request will be reviewed only if the current borrower, Western Apartment Supply & Maintenance Co., secures two new 55 year Ground Leases from the State of Hawaii, in a form and with terms acceptable to La Jolla Bank, F.S.B.

TERMS OF APPLICANTS LOAN REQUEST

Borrower(s): Western Apartment Supply & Maintenance Co.

Guarantor(s): Carroll Davis

Requested Loan Amount: \$14,000,000 **Maximum Loan Amount**

Purpose: Refinance Only

Loan Fee: 1.5% of the new loan amount

Interest Rate: Prime + .25%, floating monthly

Loan Term: 30 year amortization, all due in 15 years

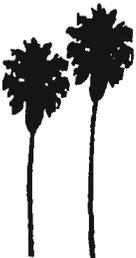


EXHIBIT B

Page 1 of 3

Rate Adjustment: Monthly

Maximum Loan to Appraised Value: 70%

Minimum Debt Service Coverage: 1.25%

Prepayment Penalty: None.

Assumable: No. Impounds: No.

Collateral: 1st Mortgage on subject property

Impounds: No

Ceiling Rate: 12.95% Floor Rate: 6.95%

Conditions Prior to Underwriting: This loan is subject to the satisfaction of the following conditions on or prior to Underwriting:

- (a) A new appraisal satisfactory to the lender**
- (b) New 55 year Ground lease (s) replacing the current ground lease and the Revocable Permit #7235 for parking**
- (c) A satisfactory inspection of the Project by Lender; and;**
- (d) The Guarantor and the existing collateral for the current financing remains unchanged.**

Estimated Loan Fees:

Credit Report	\$per quote
Appraisal	\$per quote
Processing	\$5000
Loan Points	\$per quote above
Title Insurance	\$per quote - Title Guaranty of Hawaii
Escrow	\$per quote - Title Guaranty Escrow Services
Documents	\$1000
Recording	\$per quote
Tax Service	\$per quote
UCC1 Filing	\$per quote
Flood Certification	\$20
Attorney	\$Per Quote
Miscellaneous	\$all other third parties fees are at borrower's expense

EXHIBIT B

An Interest Reserve Account may be required from loan proceeds at the time of loan funding.

An Appraisal Report will be required and will be ordered by the Bank through one of its approved appraisers. An updated Environmental Assessment Report may be required and would be ordered by the Bank through one of its approved environmental inspection firms.

A non-refundable Processing Fee of \$5,000, a Credit Report Fee of \$300 for each applicant, and a \$1,000 deposit for attorney's fees is required to be submitted with the application. All other costs related to the closing of this loan, if approved, will be the responsibility of the borrower/applicant, including but not limited to title policy, survey and recording fees.

It is understood that the Bank, in accepting these fees, is in no manner committing to a loan to the borrower/applicant. These fees are paid by the borrower in recognition of the complexities of the loan being requested. The borrower realizes that valuable resources will be expended by the Bank in reviewing and processing this loan request and that they should be given reasonable time for review of the application.

Please indicate your approval and acknowledgment by signing below and returning this document to the Bank with a check in the amount of \$6,300. If no response is received by April 1, 2009, the Bank shall consider this request to be withdrawn/cancelled by the borrower/applicant and no further action will be taken by the Bank.

Sincerely,



Martin Rodriguez
Chief Credit Officer

Approved and acknowledged:



Date

2/20/09

Date

