

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

January 13, 2011

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

Ref: GL 4644

OAHU

Request to Reduce the Performance Bond Requirement; General Lease No. 4644;
Vallejo Venture 99, LLC, Lessee; Waimalu, Ewa, Oahu; TMK (1) 9-8-013:014

BACKGROUND:

General Lease No. 4644 ("Lease") was issued by public auction on May 14, 1980 for a term of fifty-five (55) years. The leased property has been developed into a commercial center. Around April 2005, Vallejo Venture 99 LLC ("Lessee") became the lessee pursuant to a foreclosure proceeding. Under the Lease, the Lessee is required to post a performance bond equivalent to two times the annual rent. Currently, the required bond amount is \$858,000 and the Lessee is in compliance by a letter of credit. A map showing the location of the subject parcel is attached as **Exhibit A**.

Recently, the Lessee met with the Department and the parties discussed the possibility of reducing the amount of the performance bond. Rents are due semiannually. Staff indicated that it could not recommend a bond amount lower than six months of rent, or \$214,500.

In the Lessee's letter attached as **Exhibit B**, the Lessee explained that the credit market has tightened and the financial institutions are apparently reluctant to advance credit.

The Lessee discussed it has had to grant concessions to its tenants during their financial difficulties that included rent reductions, deferrals, forgiveness of scheduled rent increase and back rent. The Lessee has also had to offer tenant improvement allowances to prospective tenants to rent space at the center. In 2009 and 2010, the Lessee spent over \$100,000 for tenant improvements. Lessee plans to spend another \$100,000 to \$150,000 in the near future in improving the shopping center.

The Lessee believes with the above concessions, it will raise the occupancy of the shopping center to 100% by bringing in two (2) more tenants in early 2011. At the same time, the Lessee has approached a local bank regarding setting up a cash bond in the

amount of six months of rent under the name of the State of Hawaii and the Lessee. See **Exhibit C.**

The reduction in revenues, the planned improvement expenses, and the tightened credit market trigger the need for the Lessee to request a reduced amount of the performance bond.

REMARKS:

Paragraph 29 of the Lease provides for waiver or modification of the performance bond provision upon substantial compliance by the lessee of the terms, covenants and conditions of the Lease. It also reserves the right of the State to reactivate or reimpose the bond, if need be at any time throughout the lease term.

Records show there were two waivers of performance bond under the Lease as authorized by the Board on February 14, 1986 and January 27, 1995. The 1986 approval was based on the substantial improvement placed on the land by the lessee. In 1995, the Board relied on the “regular and prompt adherence to all of the conditions of the lease for 15 years” before it approved the waiver.

Since the Lessee took over the Lease in 2005, there were two Notice of Defaults (NOD) issued for lack of performance bond. Both of them were rectified in a timely manner. Another NOD was issued for improper signage in 2009. Again, the default was corrected within a reasonable amount of time. There has been no NOD issued for delinquent rent or lack of liability insurance.

Staff conducted an inspection to the shopping center and noted the premises was well maintained by the Lessee. According to the Lessee, the occupancy rate is at 90% and it is expected to rise up to 100% shortly. Most of the major tenants have a number of years left on their subleases. The Lessee argues that in the event of its default, the mortgagee will likely step in and cure the default, or the State would receive a fully operational shopping center with paying tenants.

On December 5, 2006, the Chairperson gave its consent to the mortgage for a loan of \$10.5 million, with Allstate Life Insurance Company as the mortgagee.

In view of substantially full compliance of the Lease by the Lessee since 2005, staff recommends the Board reduce the performance bond requirement to \$214,500, which is equivalent to six months of rent.

Staff recommends the Board approve the request subject to the condition that in the event the Lessee violates any term or condition of the Lease in the future, then the Chairperson may, with thirty (30) days written notice, require that the full performance bond (two times the annual rent) be posted. The failure to timely post the required bond shall be

deemed a material default and the State may terminate the Lease and pursue all other rights and remedies it may have.

RECOMMENDATION: That the Board reduce the performance bond requirement for General Lease No. 4644 to an equivalent of six months of rent, further subject to the following:

In the event the Lessee violates any term or condition of the Lease in the future, then the Chairperson may, with thirty (30) days written notice, require that the full performance bond (two times the annual rent) be posted. The failure to timely post the required bond shall be deemed a material default and the State may terminate the Lease and pursue all other rights and remedies it may have.

Respectfully Submitted,

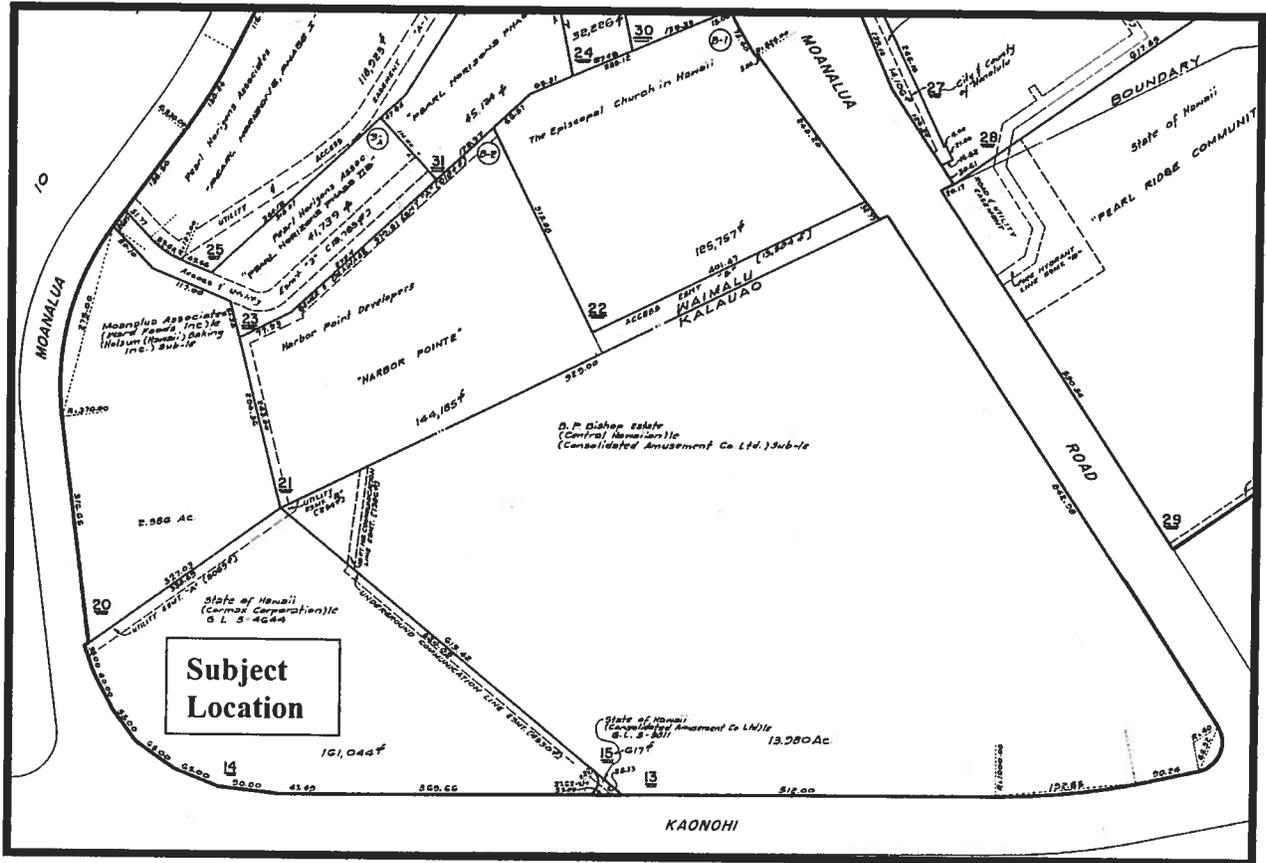


Barry Cheung
District Land Agent

APPROVED FOR SUBMITTAL:



William J. Aila Jr., Interim Chairperson



TMK (1) 9-8-013:014

EXHIBIT A



SCHLACK ITO
A LIMITED LIABILITY LAW COMPANY

Carl J. Schlack, Jr.
Attorney at Law

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December 15, 2010

Mr. Russell Y. Tsuji
Administrator, Land Division
Department of Land and Natural Resources
Kalanimoku Building
1151 Punchbowl Street, Room 220
Honolulu, Hawaii 96813

VIA EMAIL & REGULAR MAIL

Westridge Shopping Center
General Lease No. S-4644

Dear Mr. Tsuji:

We represent Vallejo Venture 99 LLC (“Lessee”), the lessee under that certain General Lease No. S-4644 dated August 26, 1980 (the “Lease”) with the State of Hawaii (the “State”). We are writing this letter to request a reduction in the performance bond amount required under the Lease from an amount equal to two times the annual rent (currently equal to \$858,000), to an amount equal to the semi-annual payment of rent (currently equal to \$214,500) for the reasons set forth herein.

A. BACKGROUND

The Lease is a ground lease for a term of 55 years, with an expiration date of May 13, 2035, for property situated at the north corner of Moanalua Loop and Kaonohi Street in Aiea, Oahu, containing an area of approximately 3.697 acres (the “Property”). The Property is fully improved and contains a shopping center known as the Westridge Shopping Center (the “Shopping Center” or the “Westridge Shopping Center”). The current annual rent is \$429,000, paid semi-annually on May 14th and November 14th of each year.

EXHIBIT "B"

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The Lease requires that the annual rental be reset at the expiration of the 20th, 30th, 40th and 50th years of the term of the Lease. The annual rent for the first 20 years was \$91,000. The annual rent for the period from May 14, 2000, to May 13, 2010, was \$269,000. As noted above, the current annual rent for the period from May 14, 2010, to May 13, 2020, is \$429,000.

Lessee has been the lessee under the Lease since April 15, 2005, through an assignment and assumption of lease from PCCP/LDC Pearl Kai, LLC, with consent given by the State. Lessee's leasehold interest is encumbered by a mortgage (the "Mortgage") in favor of Allstate Life Insurance Company (the "Mortgagee"). Consent to the Mortgage was given by the State.

Since becoming lessee under the Lease, Lessee has punctually paid all rentals to the State. Lessee has also maintained the Property in good condition and repair, has addressed all necessary improvements on a timely basis, has provided the State with current certificates of insurance as required under the Lease, and otherwise has complied with all applicable terms and conditions of the Lease.

Mr. Norman La Caze is the majority owner of Lessee and also the majority owner of the entity that owns the shopping center known as the Pearl Kai Shopping Center. The Pearl Kai Shopping Center is also maintained in good condition and repair and lessee thereunder timely pays the ground lease rent to its ground lessors. Mr. La Caze is a very experienced owner and operator of neighborhood and regional shopping centers, including several in Torrance, California. Lessee has been and continues to be a responsible shopping center owner who contributes to the State's economy and fulfills its contractual obligations.

B. BOND REQUIREMENT UNDER THE LEASE

Section 18 of the Lease requires Lessee to post a bond in an amount equal to two times the annual rent then payable to ensure the full and faithful observance and performance by Lessee of all of the terms, conditions and covenants of the Lease. The current amount of bond being posted by Lessee is \$858,000, through a letter of credit issued by the American Business Bank in Southern California.

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Section 29 of the Lease gives the State the right, at its discretion, to waive or suspend the performance bond, ***or to modify the same by reducing the amount thereof***; provided, however, that the State reserves the right to reactivate or reimpose said bond in and to its original tenor and form at any time throughout the term of the Lease.

C. BASIS OF REQUEST FOR A REDUCTION IN THE BOND AMOUNT

Lessee hereby requests a reduction in the bond amount required under the Lease from an amount equal to two times the annual rent (currently equal to \$858,000), to an amount equal to the semi-annual payment of rent (currently equal to \$214,500) for the following reasons:

1. **Tightening of the Credit Market.** As is widely known, the ability to secure credit has become increasingly difficult due to the tightening of the credit markets and financial institutions' reluctance to advance credit, even to credit worthy clients. Lessee's bank has indicated that the letter of credit in the amount of \$858,000 far exceeds the amount it normally issues, but it did so in the instant case due to Lessee and Mr. La Caze's financial worthiness and stability. Nevertheless, Lessee's bank has indicated that it will be unable to continue to provide a letter of credit of such magnitude for an extended duration and, moreover, stated that it will revisit the issuance of the letter of credit in approximately six months.

At the time Lessee acquired the Property, the rent was \$269,000 per year and banks and other financial institutions were willing to extend credit. Since then, however, the substantial increase in the amount of the required bond (\$858,000), coupled with the ongoing credit crunch in the financial marketplace, has led Lessee to this request for a reduction in the bond requirement.

2. **Tenant Concessions.** With the downturn in the economy, the tenants of the Shopping Center have felt the impact of reduced consumer spending and belt tightening by Oahu's families. Rather than ignoring such tenant hardships, Lessee has chosen to work with and assist tenants who

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are responsible and reliable, but are having financial difficulties. In an effort to retain these tenants, Lessee has granted its tenants concessions in the payment of rent, including rent reductions, deferrals or forgiveness of scheduled rent increases, and/or forgiveness of back rent. These tenants include both national tenants as well as "mom and pop" type of businesses that are essential to our local economy.

While such rent concessions have helped its tenants survive, they have also affected Lessee's profitability in its operation of the Shopping Center. In addition, not only has Lessee's income from tenant rentals decreased, its managing and operating costs have increased further necessitating Lessee's need for a reduction in the bond amount required under the Lease.

3. **Tenant Improvement Costs.** As in all shopping centers, the Westridge Shopping Center experiences a turnover in tenants and has available space for rent. Lessee has found that because of the downturn in the economy, it has had to offer increased tenant improvement allowances to entice tenants to rent space at the Shopping Center and to get a broader mix of quality tenants which results in a stronger performing shopping center. For example, Lessee has paid an amount in excess of \$100,000 for tenant improvements in 2009 and 2010, and plans to invest an additional \$100,000 to \$150,000 in tenant improvements and commissions to entice new tenant prospects to rent space in the Shopping Center in the near future.

Again, such costs affect Lessee's profitability, and its long term ability to continually improve the Property.

D. LESSEE'S PROPOSAL FOR REDUCTION IN BOND REQUIREMENT

Rather than post a letter of credit in the amount of twice the annual rent, Lessee requests that it be allowed to deposit in cash, the sum of \$214,500, being the semi-annual rental payment, in a joint bank account with the State. In the event of a default under the Lease, and after proper notice and an opportunity to cure to the extent required by the Lease (including Mortgagee cure rights), such funds would be accessible to the State for such uncured default.

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Such joint bank account would be established with a Hawaii bank mutually acceptable to Lessee and the State.

Lessee submits that the cash deposit of \$214,500 is more than adequate to protect the State in the event of a default for the reasons listed below.

1. **The Westridge Shopping Center is Fully Improved and Tenanted.** In the event of a default under the Lease, after proper notice is given and the opportunity for cure has passed, the Board of Land and Natural Resources has the contractual right and the statutory right to terminate the Lease and take possession of the Property. In such event, the State would receive the Property fully improved with an operating Shopping Center that is in good condition. Since becoming Lessee under the Lease, Lessee has installed an overlay cap on the parking lot, constructed an adjoining staircase on the Property, replaced the fence along the Kam Drive-In Swap Meet property, installed lighting for the overflow parking lot, and this year, repaired pot holes in the parking lot. All of this upkeep and repair inures to the benefit of the State in the event of an uncured default under the Lease whereby the State would take possession of the Shopping Center.

In addition, the Shopping Center currently has a tenant occupancy rate of 90% and Lessee is currently negotiating with two new tenants which will bring the occupancy rate to 100%. Major tenants of the Shopping Center have a number of years left on their leases before the terms of such leases expire. For example, Tony Roma's has approximately 10 years left on its lease, KFC's lease expires in 2027, and the various banks located at the Shopping Center have between 5 and 10 years remaining on the terms of their leases.

Thus, the State would receive the Property fully operational with paying tenants. Although the recent economic downturn has made it more challenging to be profitable, the Westridge Shopping Center continues to thrive and produce revenue. Thus, in the event of an uncured Lessee default, the cash deposit of \$214,500 would be more than sufficient to cover any lost ground lease rents for the interim period until the State takes over the fully operational Shopping Center and directly receives tenant rental payments.

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2. **Lender's Interest in Curing Lessee Defaults.** As noted above, Lessee's interest is encumbered by the Mortgage in favor of the Mortgagee. In the event of a Lessee default, the State is also required under the Lease and by statute to provide notice of such default to the Mortgagee. The Mortgagee has a vested interest in curing any such default, especially a monetary default, prior to the State instituting any Lease forfeiture action given that the Lease is the Mortgagee's collateral. Traditionally, lenders have been willing to satisfy the lease requirements of their borrower/lessee where the borrower/lessee has defaulted in its obligations under a lease where the lender's collateral is at stake. This should give the State additional comfort that any default by Lessee will not go uncured.

In conclusion, Lessee respectfully requests that the State allow a reduction in the performance bond requirement in the Lease from an amount equal to two times the annual rent to an amount equal to the semi-annual rent payment. Lessee submits that even with this reduction in the bond amount, the State will continue to be adequately protected in the remote event that Lessee defaults under the Lease, requiring the State to pursue a forfeiture of the Lease.

Thank you for your consideration of this matter. Should you have any questions or require additional information, please do not hesitate to call Carl Schlack at 523-6044 or Natalie Hiu at 523-6003.

Very truly yours,

Carl J. Schlack, Jr.
Natalie S. Hiu

CJS:mar

cc: Mr. Norman La Caze (via email only)

RECEIVED
LAND DIVISION

2010 DEC 13 P 1:31

DEPT. OF LAND &
NATURAL RESOURCES
STATE OF HAWAII



December 13, 2010

TO: Russell Tsuji
FR: Norm La Caze
RE: Westridge Shopping Center Ground Lease

Thank you for taking the time to meet with me last week. After that meeting, I met with Gabriel Lee, Executive Vice President of American Savings Bank. He was very familiar with the shopping center, and he is willing to consider a cash bond for six (6) months rent (\$200,000 – \$250,000), that would be deposited in his bank (in the State of Hawaii's states name) if there is a default on a ground rent payment. I have agreed that I would move all of the checking accounts for this property into his bank (I have no current banking relationships in Hawaii). So hopefully you can get the six (6) months approved, and a local bank would have a new business.

I will be sending a letter from the City of Torrance, stating their satisfaction with our companies operations at our shopping centers (which are on ground lease with the City of Torrance) before your January meeting.

After our meeting, I met with two (2) tenants who will be occupying the vacant space in the center, so we should be back up to 100% occupancy after the first of the year. To accomplish this, we will again have to invest somewhere between \$100K and \$150K in TI and Commissions. Garrett Littman will be sending to you the amount of money we have invested in maintaining and improving the property in the past five (5) years, together with some of the loss income due to the downturn of the economy.

Hopefully your meeting goes well, if I could be of any assistance please let me know.

Sincerely,

A handwritten signature in black ink, appearing to read "Norm La Caze", is written over a large, loopy scribble. The signature is positioned above the printed name "Norm La Caze".

Norm La Caze