

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

December 14, 2012

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

Hawai'i

**Consent to Sublease General Lease No. 3265, Hilo Bay Hotel, Inc., Lessee, to
Banyan Drive Cafe LLC, Sublessee, Waiakea, South Hilo, Hawaii, Tax Map
Key:3rd/2-1-05:33.**

APPLICANT:

Hilo Bay Hotel, Inc., a Hawaii corporation, as Sublessor, to Banyan Drive Cafe LLC, a
Hawaii Limited Liability Company, as Sublessee.

LEGAL REFERENCE:

Section 171-36, Hawaii Revised Statutes, as amended.

LOCATION:

Portion of Government lands of Lot 2, Ocean View Lots situated at Waiakea, South Hilo,
Hawaii, identified by Tax Map Key: 3rd/2-1-05:33, as shown on the attached map labeled
Exhibit A.

AREA:

0.586 acres, 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

GL No. S-3265

LEASE CHARACTER OF USE:

Hotel and resort purposes.

SUBLEASE CHARACTER OF USE:

Restaurant and Bar and related retail sales of souvenir items.

TERM OF LEASE:

66 years, commencing on June 15, 1948 and expiring on March 14, 2015. Last rental reopening occurred on January 8, 2005; there will be no further rental re-openings.

TERM OF SUBLEASE:

3 years, commencing on May 1, 2012 and expiring on February 28, 2015.

ANNUAL RENTAL:

\$11,460.00.

ANNUAL SUBLEASE RENTAL:

\$36,000.00.

Sublease Rent Participation Policy

The primary purpose of establishing the Board's Sublease Rent Participation Policy was to prevent lessees from speculating and profiting on fluctuating land values while benefiting from a State lease.

On May 26, 2000, agenda item D-24, the Board approved the "Revision to Sublease Rent Participation Policy", which was further amended at its meeting of January 26, 2001, agenda item D-8, and subsequently refined at its meeting of August 24, 2012, under agenda item D-14 ("Policy").

In summary, the Policy applies to three types of situations.

- a. If the lessee subleases unimproved lands, the Board shall revise the rent to include as additional rent, 50% of that portion of the sublease rent in excess of the original ground rent paid to the State.
- b. If the lessee subleases improvements owned by the State, the Board shall revise the rent to include as additional rent, 50% of that portion of the sublease rent in excess of the original ground rent paid to the State.

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- c. If the lessee subleases improvements not owned by the State, the Board shall not receive any portion of sublease rents from subleasing improved space unless: (i) that right and method of calculation are specifically stated in the lease, or (ii) participation in sublease rents is warranted considering the age of the improvements (including but not limited to the extent to which the improvements have been depreciated or amortized), lessee's expenditures to maintain the same in relation to sublease revenues, and the extent to which the lessee actually occupies and uses the lease premises for its own business.¹

This lease is silent with regards to sublease rent participation. It requires only the Lessor's consent to subletting.

RECOMMENDED ADJUSTMENT TO LEASE RENTAL:

\$8,427.00 (Refer to Exhibit B attached for review by staff on premium/sandwich calculations.)

DCCA VERIFICATION:

SUBLESSOR:

Place of business registration confirmed:	YES <u>X</u>	NO <u>__</u>
Registered business name confirmed:	YES <u>X</u>	NO <u>__</u>
Good standing confirmed:	YES <u>X</u>	NO <u>__</u>

SUBLESSEE:

Place of business registration confirmed:	YES <u>X</u>	NO <u>__</u>
Registered business name confirmed:	YES <u>X</u>	NO <u>__</u>
Good standing confirmed:	YES <u>X</u>	NO <u>__</u>

REMARKS:

General Lease No. 3265 was initially sold at a public auction of government leases held on June 15, 1948 in Hilo, Hawaii to Bernard K. Chock at the upset rental price of \$280.00 per annum. The Lessee's initial term was for twenty-one (21) years commencing June 15, 1948 and terminating on June 14, 1969.

¹ At the January 26, 2001 meeting, the Board stated on the record that the formulas in the policy generally reflect the intent of the Board regarding the calculation of sublease sandwich profit and are to serve as guidelines in such calculation. The Board also authorized the staff to use its discretion in representing the State's interest in applying these formulas to address the varying subleasing arrangements that may not fit neatly into the formulas. Accordingly, the Sublease Rent Participation Policy was never meant to be followed blindly with rigid adherence but instead, the Board had expected staff to continue to use good land management practices and standards when analyzing a sublease rent proposal and arriving at a reasonable recommendation for the Board to consider that is both fair to all parties and in the best interest of the State.

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Lessees qualified as a disaster victim under Section 87 of Act 32, Session Laws of Hawaii 1962, by the Board of Land and Natural Resources. Lease was subsequently extended on July 27, 1962 for a period of fifty-three (53) years, terminating on March 14, 2015 with rent reopening twenty (20) and forty (40) years from the most current lease agreement. The last rent reopening on January 8, 2005 was for the duration of the lease.

At its meeting of January 8, 1965, the Board consented to the assignment of lease from Rose Haena Chock, widow of Bernard K. Chock (by Probate No. 2246 in Third Circuit Court) as Assignor to William J. Kimi, Jr., as Assignee. Under the terms of the extension agreement, when a use other than the original intended house lot use is contemplated, an immediate renegotiation of the rent for the ensuing 20-year period is required. Since Mr. Kimi intended to construct a hotel on the parcel, an appraisal was conducted and the rent was established at \$2,981 per annum.

The hotel was operated as a sole proprietorship until October 1967 when Mr. Kimi incorporated the business as Hilo Bay Hotel, Inc. As a result of this action, the Board, at its meeting of June 27, 1969 (supplemental agenda), consented to the assignment of lease from William J. Kimi, Jr., as Assignor, to Hilo Bay Hotel, Inc., as Assignee.

The Lessee has requested consent to sublease a portion of the premises, which operates as a restaurant, to Banyan Drive Cafe LLC. The Sublessee has a lease agreement with Hilo Bay Hotel, Inc. effective May 1, 2012 and will expire on February 28, 2015. The intent of the Sublessee is to utilize the existing facilities for their restaurant business. No plans for improvements or alterations of the premises have been submitted to the Hawaii District Land Office.

The Lessee, Hilo Bay Hotel, Inc., constructed a hotel consisting of a lobby area, guest rooms and a restaurant/bar area on the property in 1966 at a cost of approximately \$100,000. Staff has confirmed with Lessee that only minor improvements/renovations and maintenance have been performed on the property since completion. After forty-six years, the original investment and minor improvements/renovations have been fully depreciated and may have reached or exceeded their useful life.

The lease is silent regarding sublease rent participation. It should be noted the hotel spans four properties with four separate leases (GL-3265, GL-3266, GL-3267 & GL-4252). The total combined annual lease rent charged for these properties is \$35,800.00. All four leases have an end date of March 14, 2015 and the Lessee has not applied for a lease extension pursuant to Act 219, Hawaii Session Laws 2011.

Staff is using a discounted rent participation percentage of 25% because the restaurant/bar is viewed as a significant revenue generating component of the hotel. This is evident from a comparison of the annual ground rent for the subject lease (\$11,460) and the annual sublease rent (\$36,000). Staff considers a 25% share to be fair under the circumstances.

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The Lessee is compliant with all lease terms and conditions regarding rent and insurance. This lease does not have a provision for a lease bond.

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.

RECOMMENDATION:

That the Board consent to the sublease under General Lease No. 3265 between Hilo Bay Hotel, Inc., as Sublessor, and Banyan Drive Cafe LLC, as Sublessee, subject to any applicable conditions cited above which are by this reference incorporated herein and further subject to the following terms and conditions:

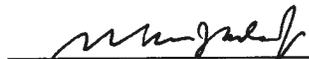
1. The lease rent shall be increased by \$8,427.00 annually, representing the sublease sandwich profits from Banyan Drive Cafe LLC, Sublessee;
2. The standard terms and conditions of the most current consent to sublease form, as may be amended from time to time;
3. Review and approval by the Department of the Attorney General; and
4. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.

Respectfully Submitted,



Candace M. Martin
Land Agent

APPROVED FOR SUBMITTAL:



William J. Aila, Jr., Chairperson

TMK: 3rd/2-1-05:33

EXHIBIT A

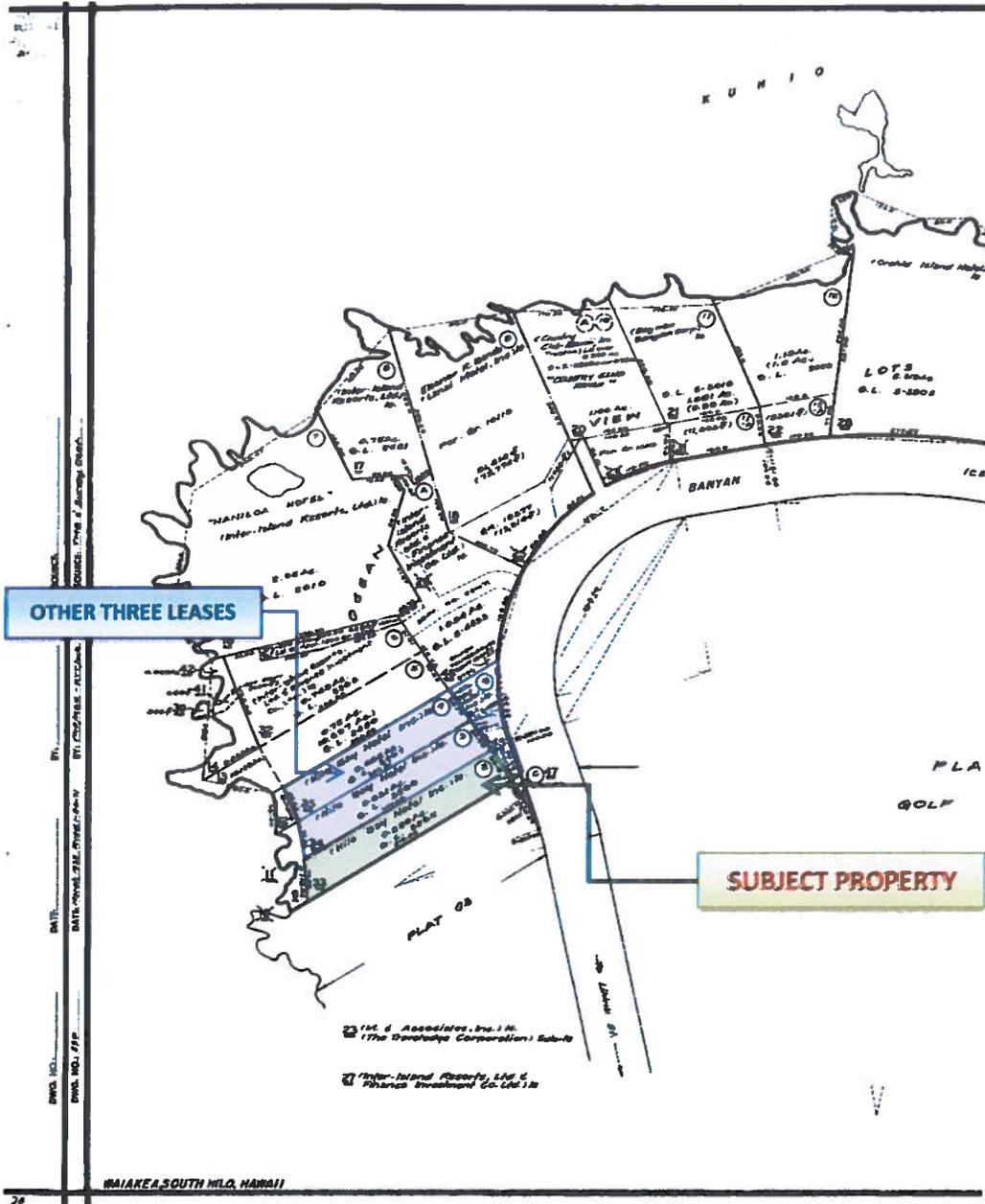




EXHIBIT B



STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
LAND DIVISION

POST OFFICE BOX 621
HONOLULU, HAWAII 96809

October 30, 2012

MEMORANDUM

TO: William J. Aila, Jr., Chairperson

THROUGH: Russell Y. Tsuji, Division Administrator

FROM: Candace Martin, Land Agent

SUBJECT: In-House Recommendation – Sublease Participation Calculation

GL No.:	3265
Lessee/Sublessor:	Hilo Bay Hotel, Inc.
Sublessee:	Banyan Drive Café, LLC
Location:	Waiakea, South Hilo, Hawai'i
Lease area:	0.586 acres (25,538 sf)
Sublease Area:	5,220 sf.
Tax Map Key:	3 rd /2-1-05:33
Character of Use:	Resort purposes

We have been requested to provide an in-house evaluation of the sublease premium due to the State for the subleasing of a portion of GL-3265, Hilo Bay Hotel, Inc. Lessee/Sublessor to Banyan Drive Café, LLC, Sublessee. The sublease documents and information provided by Lessee were analyzed and staff applied the formula approved by the Land Board on January 26, 2001, agenda item D-8, and modified by the Board at its meeting on August 24, 2012, agenda item D-14, comprising the Sublease Rent Participation Policy.

The Lessee, Hilo Bay Hotel, Inc., constructed a hotel consisting of a lobby area, 51 guest rooms and a restaurant/bar area on the property in 1966 at a cost of approximately \$100,000. It should be noted the hotel spans four properties with four separate leases (GL-3265, GL-3266, GL-3267 & GL-4252). The total combined annual lease rent charged for these properties is \$35,800.00. All four leases have an end date of March 14, 2015 and the Lessee has not applied for a lease extension pursuant to Act 219 of Hawaii Session Laws 2011.

The lease is silent regarding sublease rent participation. The Lessee, Hilo Bay Hotel, Inc., has utilized the entire property including the restaurant and bar since 1966. Only minor

improvements/renovations and necessary maintenance have been done to the property since 1966. The Lessee has recently entered into an agreement to sublease the restaurant/bar area while retaining management of the guest rooms.

CALCULATION: GL No. 3265

Annual Ground Rent (25,538 sf) \$11,460.00

Annual Sublease Rent	\$36,000.00
Less G.E. Tax	0.00*
Less Real Property Tax	0.00**
Misc. Allowances	<u>0.00</u>
Total Sublease Rent	\$36,000.00

Annual Income to Land:	\$36,000.00
Annual Ground Rent (5,220 sf of subleased area)	(2,292.00)
Annual Rental Proceeds to Lessee:	33,708.00
DLNR Rent Participation:	<u>25%¹</u>

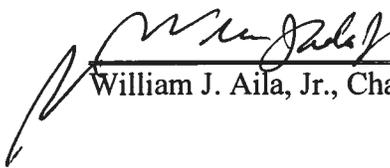
DLNR portion of Rent Participation \$8,427.00

*GE Tax is charged in addition to the sublease rent.

**Real property taxes are also charged to the sublessee.

Based on these calculations the additional annual rent due the State is \$8,427.00

Approved/Disapproved:



William J. Aila, Jr., Chairperson

11/1/12

Date

Cc: District Files
Central Files

¹ Staff is using a discounted rent participation percentage of 25% because the restaurant/bar is viewed as a significant revenue generating component of the hotel. This is evident from a comparison of the annual ground rent for the subject lease (\$11,460) and the annual sublease rent (\$36,000). Staff considers a 25% share to be fair under the circumstances.