

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

January 25, 2013

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

Oahu

Report and Request for Comments from the Land Board
Regarding Concept of Land Exchange between the State of
Hawaii and Sand Island Business Association ("SIBA") for
State-Owned Land at Sand Island, Honolulu, Oahu, Tax Map
Keys: (1) 1-5-41: Various, and Privately-Owned Property Yet
to be Identified.

APPLICANT/PRIVATE OWNER:

Sand Island Business Association, a Hawaii nonprofit corporation
whose mailing address is P.O. Box 17603, Honolulu, Hawaii 96817-
0603. Applicant is the master lessee of the "State-Owned
Property" (described below) under General Lease No. S-5261.

LEGAL REFERENCE:

Section 171-50, Hawaii Revised Statutes, as amended.

Public Purpose Requirement. "No exchange of public land for
private land shall be made except for public purposes,
including but not limited to (1) consolidation of holdings of
public lands; (2) straightening of boundaries of public lands;
(3) acquisition of adequate access for landlocked public lands
which have development potential; or (4) acquisition of lands
suitable for residential use." HRS §171-50(a).

Statutory Absolute Minimum Valuation Requirement. "The public
land exchanged shall be of substantially equal value to that
of the private land. In any exchange, the fair market value
of the private land and the public land shall be separately
determined by a disinterested qualified appraiser or
appraisers and the cost shall be borne equally between the
owner and the board. No payment by the State shall be
required should the private land exceed the value of the
public land, but any difference in value of the public land
over the private land shall be paid to the State at the time
of the exchange; provided no exchange shall be made should
public land exceed 120 per cent of the value of the private
land." HRS §171-50(b).

Act 235, Session Laws of Hawaii 2011.

Section 26-15, Hawaii Revised Statutes, as amended.

"The department of land and natural resources shall be headed by an executive board to be known as the board of land and natural resources, except for matters relating to the state water code where the commission on water resource management shall have exclusive jurisdiction and final authority."

"The department shall manage and administer the public lands of the State and minerals thereon and all water and coastal areas of the State except the commercial harbor areas of the State, including the soil conservation function, the forests and forest reserves, aquatic life, wildlife resources, state parks, including historic sites, and all activities thereon and therein including, but not limited to, boating, ocean recreation, and coastal areas programs."

Under the above authority and throughout Chapter 171 of the Hawaii Revised Statutes, land dispositions such as leases, sales of remnants and including land exchanges, are discretionary decisions with the Board of Land and Natural Resources.

PROPERTIES PROPOSED FOR EXCHANGE:

STATE-OWNED PROPERTY:

Location: Portion of the former Sand and Quarantine Islands Military Reservation transferred to the Territory of Hawaii by Presidential Executive Order 10,833 dated August 20, 1959 situated at Kaholaloa, Sand Island, Honolulu, Oahu, Hawaii, identified by Tax Map Key: (1) 1-5-41:various, as shown on the attached tax map labeled Exhibit A (the "State-Owned Property"). Additional property data is provided in the table below:

TMK	1-5-41: various
Land Area	69.119 aces, subdivided into 113 individual lots served by County-standard infrastructure
SLU	Urban
County Zoning	I-3 Industrial Waterfront & B-2 Business

Trust Status: Non-ceded, Section 5(a) lands of the Hawaii Admission Act, including "Real properties acquired by purchase or by condemnation by the Territory of Hawaii after August 12, 1898 and prior to August 21, 1959."

DHHL 30% entitlement lands pursuant to the Hawaii State Constitution: YES NO

Current Use: The property is leased to Sand Island Business

Association (SIBA) under General Lease No. S-5261. The lease term is 55 years commencing July 1, 1992 and ending June 30, 2047.

The property has been developed as an industrial park subdivision consisting of 113 individual lots served by roadways and other infrastructure. The site has access to the Sand Island Parkway Road and the topography is flat.

Comments: State-Owned Property to be conveyed shall be subject to all exceptions, exclusions, reservations and easements of record.

PRIVATELY-OWNED PROPERTY:

None at this time. SIBA does not own property that would be acceptable to the Department for exchange purposes at this time. SIBA is proposing to identify possible exchange property in the future for the Department to consider, and if the Board of Land and Natural Resources determines the property is acceptable, SIBA will then seek to acquire the property. No potential properties have yet been identified and staff is not aware of any preliminary negotiations by SIBA to acquire any property.

FAIR MARKET VALUE OF STATE-OWNED PROPERTY:

Section 171-50(b), HRS, requires that the public land exchanged be of substantially equal value to that of the private land, and that the fair market value of the private land and the public land be separately determined by a disinterested qualified appraiser or appraisers.

Market value is defined as the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus.

The Department retained the appraisal firm Hastings, Conboy, Braig & Associates, Ltd. to determine the fair market value of the State-Owned Property for the purpose of the proposed land exchange. The appraisal determined a value of \$176,480,000.00 as of May 7, 2012.¹

CHAPTER 343 - ENVIRONMENTAL ASSESSMENT:

The proposed exchange would represent a use of State lands to acquire improved property and would not be exempt from the

¹ Summary Appraisal Report of the Unencumbered Fee Simple Interest in the Land Underlying 113 Individual Lots within the Sand Island Industrial Park dated May 10, 2012 prepared by Hastings, Conboy, Braig & Associates, Ltd.

provisions of Chapter 343, HRS, relating to environmental impact statements. In the event the Board approves the exchange and the acquisition of private lands by the State, the Applicant shall be responsible for compliance with Chapter 343, HRS, as amended.

REMARKS:

BACKGROUND

Sand Island Business Association (SIBA) has requested that the Board of Land and Natural Resources (Board) approve in concept, an exchange whereby the State would convey its interest in approximately 69.119 acres of the State-Owned Property for property with equal or greater value and income producing potential, subject to review and approval by the Board and the Department of the Attorney General.

DEVELOPMENT OF THE INDUSTRIAL PARK

In 1992, the Department entered into a 55-year master lease with SIBA for the Sand Island Industrial Park (the "Master Lease") at Sand Island, Oahu. The Industrial Park is approximately 70 acres in size and consists of 113 individual lots, which lots are sublet by SIBA to individual tenants. SIBA is a non-profit organization, whose members consist of the individual tenants of the industrial park. The Master Lease was an arms-length negotiated lease, and the terms and conditions were negotiated and agreed to by both SIBA and the Department. The right of a lessee to acquire the fee simple interest is normally a negotiated term of a lease, with such a right usually being granted in exchange for consideration from the lessee. The Master Lease, however, does not grant SIBA or its tenants the right to acquire the underlying fee simple interest. To grant such a right to SIBA or its tenants by legislation, especially without consideration to the Department for such a right, poses a potential violation of the Contracts Clause of the United States Constitution. Staff would therefore recommend that any exchange include a premium to the State in terms of exchange value, income stream and/or other consideration.

ACT 235, SESSION LAWS OF HAWAII 2011

Act 235, Session Laws of Hawaii 2011, states that SIBA members have expressed a strong interest in purchasing the fee interest of their leasehold parcels, and that as the lease period shortens, it becomes more difficult for the members to rely on the leasehold as an asset when attempting to secure bank loans for additional improvements. Based on the above, Act 235 allows the Board to consider the sale of the Sand Island parcels to the tenants or the exchange of the Sand Island parcels to the tenants for other lands at Sand Island owned by the tenants. Act 235 allows the Department to consider various factors (in addition to pure land value) when reviewing a proposed sale or exchange, including the remaining term of the Master Lease, the current and

projected lease revenues to the Department from the Master Lease, and the value of, and income stream from, the parcel proposed for exchange.

The Act requires that the Department report to the Legislature on the Department's review and consideration of the sale or exchange of Sand Island parcels to tenants, and the Department's recommendations for further action.

One of the stated purposes of Act 235 was to address the SIBA tenants' concerns about obtaining financing for additional improvements. The Department, however, believed that this issue had already been addressed. SIBA had previously informed the Department that it was difficult for SIBA tenants to obtain financing because the Master Lease provides for the lease rent to be redetermined by appraisal for the 10-year period commencing July 1, 2017, and lenders were not willing to issue loans for terms longer than the remaining "known rent" period.

The Department met with SIBA and requested SIBA provide additional information regarding its tenants' financing needs, including how many tenants were seeking financing and the purposes and amounts of the financing sought by the tenants. The Department sought to determine: (1) Whether there were a large number of the tenants or only a handful of tenants that needed financing; (2) The purposes and amounts of the financing needed as such information usually dictates the loan terms a bank is willing to offer (e.g., capital improvement loans for large amounts would qualify for long-term loans amortized over 15 years or more, whereas smaller loan amounts or working capital loans would normally be amortized over a 3-5 year period); and (3) Whether the types of financing needed required the tenant to mortgage its interest in the Sand Island property. There was no conclusive evidence that long-term, real estate secured financing was required by a substantial number of SIBA's tenants. However, to assist the SIBA tenants' financing efforts, the Department agreed to conduct the rent reopening scheduled for July 1, 2017 immediately, which would result in the rent being fixed through June 30, 2027. This would result in a known rent period of 16 years, which would allow tenants to seek both short-term and long-term financing.²

LEASE RENT

The initial rent under the Master Lease was established at fixed, below-market rates for the first 25 years, i.e., from 1992 to 2017. Staff believes the purpose of the reduced rent was to allow SIBA to recover its costs of infrastructure improvements for the industrial park. However, staff has determined that even with SIBA paying for the infrastructure (via repayment of the

² Conducting the reopening early was not the Department's preference because it puts the State at risk if the real estate market improves in a manner not anticipated in the appraisal. The Department did so solely to help SIBA address the financing concerns expressed by its tenants.

infrastructure loan), and adding to that cost the management fee for the park, and the discounted rent, the total paid by SIBA over the first 25 years of the lease is significantly less than the fair-market rental for the same period.³

The Department retained an independent appraisal firm to determine the prospective fair market rent for the ten-year period commencing on July 1, 2017. The appraisal was completed on June 22, 2011 and concluded the prospective fair market rent for the Master Lease beginning July 1, 2017 to be \$9,285,600. On September 20, 2011, SIBA accepted the new rent.

The appraisal also determined the current (2013) fair market rent for the SIBA lands is \$8,250,100. Under the terms of the Master Lease, SIBA is currently paying an annual lease rent of \$4,908,284. As such, the rent SIBA is presently paying is more than \$3.3 million below the current fair market rent.⁴ This subsidy of substantially below-market rents has existed since the inception of the lease in 1992 and will continue until 2017.

On December 28, 2011, SIBA submitted a proposal for an exchange to the Department that relied on the June 22, 2011 appraisal's fee simple value (\$97,206,800) as the exchange value. The Department, however, explained to SIBA that the June 22, 2011 value was derived for the specific purpose of determining prospective fair market rent for the Master Lease and was not appropriate and could not be used to establish fair market value for sale or exchange purposes.

Consequently, the Department sought and obtained from Hastings, Conboy, Braig & Associates, Ltd. a new appraisal for the specific purpose of determining fair market value for sale or exchange of the State-Owned Property. The Summary Appraisal Report prepared by Alan J. Conboy, dated May 10, 2012, concluded that the aggregate retail value of the fee simple interest in the State-Owned Property was \$175,670,000.00 as of May 7, 2012.

PUBLIC PURPOSE

Revenues generated by the public land trust are used to fund various public purposes consistent with the Department's fiduciary obligations to protect, preserve and manage the State's natural resources, including open spaces, conservation and culturally significant lands, wildlife habitat, ocean recreation,

3 The lease requires SIBA to build the infrastructure to City and County standards and to dedicate the same to the City and County. SIBA has neglected to satisfy this requirement and has requested the waiver of the requirement. To date, the infrastructure remains undedicated and staff is concerned that SIBA's failure to dedicate the infrastructure adversely affects the property.
4 The current (below market) rent reflects stepped up rents from prior years. The prior annual rents were as follows:

Period	Annual Rent
7/1/92 - 6/30/97	\$1,227,071.00
7/1/97 - 6/30/02	\$3,067,677.60
7/1/02 - 6/30/12	\$3,834,597.00

aquatic resources, etc.⁵ These revenues fund 100% of the operating expenses of both Land Division and the Office of Conservation and Coastal Lands, as well as three positions in the Commission of Water Resource Management, lifeguard services at one of the State beaches on the Waianae coast in the amount of \$700,000 per year, the dam safety program, the geothermal program, contribute to the protection of threatened and endangered species, eradication and control of invasive species, and to the cost of fighting wildland fires. Moreover, these funds are often used when emergency responses are required due to flooding, earthquakes, rockfalls, or other natural disasters.

The State-Owned Property is of immense importance for sustaining the ongoing operations of the Department. The Board determined that the Department should utilize a portion of the lands it manages to generate revenues to carry out its fiduciary duties and support the Department's operations and management of public lands and programs. This is especially critical at this time due to the State's struggling economy. The lease revenues generated by the Sand Island lands constitute about 50% of all lease revenues currently supporting the Department's Special Land Development Fund. As such, staff does not recommend this proposed transaction unless the value of the exchange property substantially exceeds the value of, and revenues from, the State-Owned Property, so that the Board is compensated for the loss of its single most important revenue asset and the imposition of greater financial risks. Staff does not believe a straight exchange (value for value) in this instance would serve a public purpose or be in the best interest of the Department.

SELECTION FACTORS FOR EXCHANGE PROPERTY

If the Board were inclined to pursue the exchange, Staff would recommend that the following preliminary factors be used by SIBA to identify desirable properties that the Land Board may consider for exchange purposes. These preliminary factors are meant to identify lands that can generate revenue and provide future redevelopment opportunities for the benefit of the Department. Staff would not support an exchange at the minimum value allowable under the statute. The selection factors include:

⁵ The Department is charged with management of the State's natural resources including water resources, ocean waters, navigable streams, coastal areas, minerals, state parks, historical sites, forests, forest reserves, aquatic life & aquatic life sanctuaries, public fishing areas, boating & ocean recreation, coastal programs, wildlife & wildlife sanctuaries, game management & public hunting areas, natural area reserves, and other functions assigned by law. The Department also manages over 1.3 million acres of public lands, and the Hawaiian waters out to the 3-mile mark. The Department utilizes a small percentage of these lands to generate revenues to support and fund the Department's trust responsibilities and other related programs. This management philosophy is similar to those employed by other major land trusts, which utilize a portion of their lands for revenue generating purposes to support the missions and purposes of their respective trusts.

- Interest: Only fee simple or leased fee interests should be considered.
- Zoning: Sites should have Urban State Land Use designations and be zoned for commercial or industrial use by the county.
- Location: Properties statewide may be considered. Priority, however, should be given to properties located in areas with high demand for commercial and/or industrial lands, such as the central business district and areas in the proximity of major transportation facilities (e.g., airports, harbors, and freeways).
- Improvements/Current Use: Improved properties served by county-standard infrastructure and occupied by viable tenants under lease terms acceptable to the Department are preferred over vacant lands or lands with aging improvements and infrastructure. Moreover, no residential improvements are permitted.
- Exchange Premium: The rents derived from the State-Owned Property constitute nearly half of the Land Division's annual revenue income. Due to the unique and critical role that the State-Owned Property plays in ensuring fiscal stability and certainty for Department, a significant premium over and above the fair market value determined by appraisal shall be included in the exchange values.

Once properties/lands are identified, the exchange proposal would come back to the Board for consideration. Staff hopes and contemplates that any proposal considered by the Land Board will include the land value of the State-Owned Property (\$175,670,000) plus a significant incentive premium for the Board, and an income stream with a present value that is equal to or greater than the present value of the income stream of the remaining 36 years of the SIBA lease (based on the 2017 annual rent of \$9,285,600.00 with periodic step-ups and reopenings, plus a significant incentive premium for the Board).

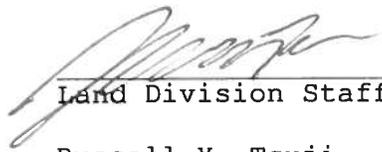
Once the private property is identified and the exchange approved by the Board, SIBA would be able to begin necessary environmental assessments or environmental impact statements, as may be required under Chapter 343, Hawaii Revised Statutes. Moreover, additional due diligence would be conducted and presented to the Board for review and final approval.

Comments were not solicited from other government agencies as staff is only reporting to the Board on SIBA's request and seeking the Board's comments at this point.

RECOMMENDATION:

The foregoing report is provided for informational purposes only.
Staff makes no recommendation at the present time.

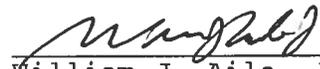
Respectfully Submitted,



Land Division Staff

Russell Y. Tsuji
Administrator

APPROVED FOR SUBMITTAL:



William J. Aila, Jr., Chairperson

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ENVIRONS MAP
Sand Island Business Park
Honolulu, Oahu, Hawaii



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Google

Subject

Image © 2011 GeoEye
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Image USGS
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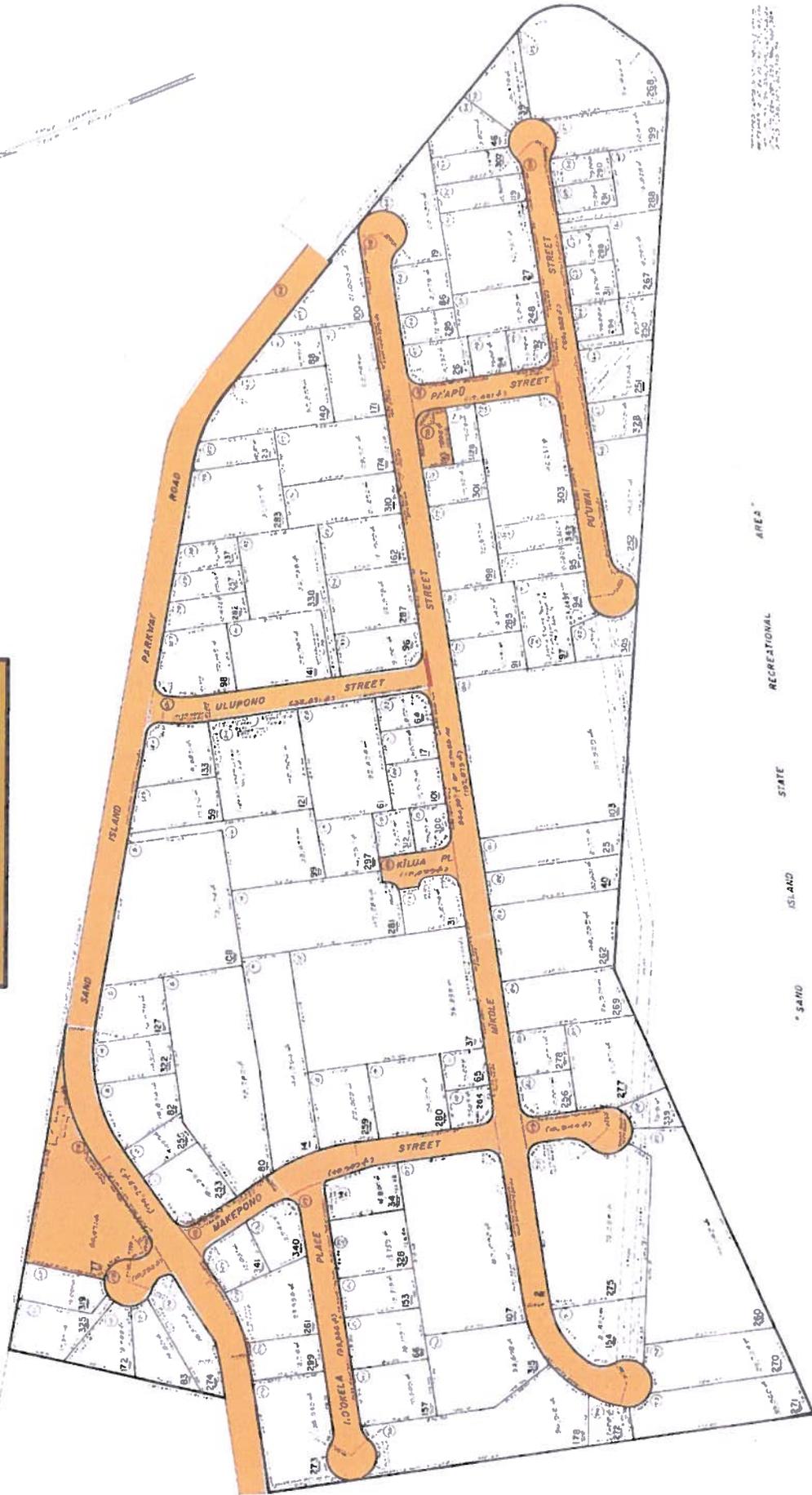
EXHIBIT A

AERIAL MAP
Sand Island Business Park
Honolulu, Oahu, Hawaii



PROPERTY LOCATION MAP
Sand Island Business Park
Honolulu, Oahu, Hawaii

Excluded Parcels



CITY OF HONOLULU PLANNING DEPARTMENT PLANNING DIVISION MAP	
NO.	SECTION
1	5
41	

These parcels & sections are shown as they exist and may vary from the actual parcels & sections as shown on the ground. The City of Honolulu is not responsible for any errors or omissions on this map.

SUPPLEMENTARY MAP