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SUZANNE D. CASE
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DEPARTMENT OF LAND AND NATURAL RESOURCES

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Testimony of
SUZANNE D. CASE
Chairperson

Before the House Committee on
WATER, LAND, & HAWAIIAN AFFAIRS

Friday, February 1, 2019
9:00am
State Capitol, Conference Room 325

In consideration of
HOUSE BILL 1025
RELATING TO LEASE EXTENSIONS ON PUBLIC LAND

House Bill 1025 proposes to authorize the Board of Land and Natural Resources (Board) to extend leases of public lands for commercial, industrial, or resort use upon approval of a proposed development agreement to make substantial improvements to the existing improvements. The measure would repeal on June 30, 2024. **The Department of Land and Natural Resources (Department) strongly supports this Administration measure.**

During the 2018 legislative session, the Department took a neutral position in testimony on legislative bills that proposed to allow existing lessees to secure extensions on leases that are scheduled to expire soon, due to the general public policy to promote fairness in competition in access to public property. The Department cited to Section 171-32, HRS, which favors issuance of leases by public auction, in support of its public policy statement. The Department additionally testified that another reason not to permit lease extensions was to preserve the State's legal right to the remaining value of the improvements after the lease term, if any. When leases expire, the lessees' improvements on the land revert to State ownership pursuant to the express terms of the lease, unless the State directs the lessee to remove the improvements. Assuming the improvements have some remaining useful life (which is not always the case), the State is then in a position to auction leases of improved properties at potentially greater rents than the State would receive for a ground lease alone, which amounts can in turn be applied to public purposes.¹

¹ However, in the Department's experience, leasehold improvements at the end of a 65-year lease term generally do not add significant value to the fair market rent that can be charged for the property.

Although the Department raised these concerns in its testimony last session, the Legislature and Governor passed Act 149 SLH 2018, which provided for the extension of leases in a region of Hilo under a 10-year pilot project. Act 149 authorized the extension of commercial, industrial, and resort leases of public lands located in the Hilo community economic district. Some additional concern was raised about Act 149 constituting special legislation due to the geographical limitation of its applicability. The Department believes that if the policy of the Legislature is to make lease extensions available to existing lessees, the policy should have statewide application and not be limited to any particular island or region.

House Bill 1025 is an Administration proposal that would therefore authorize the Board, on a "statewide basis", and for a limited period (to be repealed on June 30, 2024), to extend commercial, industrial, or resort leases that have not been sold or assigned within 20 years prior to receipt of an application for a lease extension under the measure, when the lessee commits to substantial improvement to the existing improvements, provided that lease extensions cannot exceed 40 years, and additionally, the lessee cannot transfer or sell the lease during the extension period, except by devise, bequest, or intestate succession.

If the bill does not pass, leases near the end of their terms outside of the Hilo community economic district will expire in due course and new leases of the properties will be offered for sale at public auction. Existing lessees who are not the successful bidders at auction will have to relocate their businesses.

Thank you for the opportunity to comment on this measure.

McCully Works
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January 31, 2019

HB 1025; Support with Comments

House Committee, Water, Land, and Hawaiian Affairs
Chair: Ryan Yamane Vice-Chair: Chris Todd

Aloha Chair Yamane,

HB 1025 seeks to extend the reforms that the Legislature established in Act 149, 2018 beyond the Hilo Economic District to similar economic leases statewide. Act 149 restricted the amending of HRS171 to only lands zoned commercial, industrial, and resort. This bill similarly restricts its amendments to only those types of lands. This bill was preceded by the December 24, 2018 report made to the Legislature as required by Act 149 in which the department recommended what is essentially contained in this bill.

However this bill goes well beyond the statutory provisions now contained in HRS 171-192. Those statutes allow the existing lease to be extended for a limited period in exchange for substantial improvements to be made to the leasehold property. The statutory reform sought to allow for the continued utilization of the property at its highest and best economic use by allowing for continued investment so as to maintain economic viability. This bill would eliminate those benefits through a series of ill considered restrictions with severe consequences.

1. Sec 2 (a) has arbitrary language that prohibits leases assigned or transferred within the last 20 years from qualifying for a lease extension. This would affect a significant number of properties with no benefit to the state. Previously in Act 219, 2011, which allowed for extension of leases only for resort owned properties, there was a restriction for leases assigned within 5 years of the legislation. However the total number of resort leases affected was one (1) and two of the three leases that were extended under this legislation had been assigned within 20 years of Act 219.
2. Sec. 2 (d) seeks to restrict the assignment or transfer during the extension period, making it impossible to mortgage the required substantial improvements. This would completely defeat the purpose of the bill.
3. Sec. 2 (e) seeks to replace the existing lease with a "...effectuated, documented, and executed using the most current lease..". This violates the law (see State v. Kahua Ranch, 1963) by reforming the lease under the guise of an extension of the lease. The title of this bill is "Relating to Lease Extensions...".
4. Sec. 2 (g) increases the basis of "substantial improvements" to 50% of the market value of the existing improvements. This committee should question the bills supporters as to why this threshold is established. The existing language in

HRS171-192 allows for the board of land and natural resources to determine both the period of the extension as well as the period of the fixed rent based on the proposed improvements equal or exceeding 30%. The board may well deem that a minimal level of improvements may warrant a shorter period for the extension or the fixed rental term while more significant improvements warrant a full extension or fixed rental term. This flexibility allows for the lessee to make the improvements they decide that are warranted for their business at that time. The lower the minimum requirements, with the boards discretionary approval to protect the publics interest, the more likely the lessee is to maintain the property at it's highest level, which is ultimately in the publics interest.

This committee should review the proposed terms identified above which clearly undercut the intention of the bill as stated plainly in Section. 1 ;

“...Lessees have little incentive to make major investments in ...improvements ...maintenance of the facilities. As a result... these properties (are) deteriorating. “

In so far as the rationale extended by the authors of this bill in Section 1 that “...lessees typically sell or assign their leases that are nearing end of term at a discount...” the burden of proof to establish this as a finding by the legislature lies with the author. The Legislature is being provided a personal opinion or at best anecdotal information. The entire 2nd paragraph of Section 1 should be removed as inaccurate.

The above notwithstanding, this bill has merit in that extending the current statutory restrictions contained in HRS171-92 to all industrial, commercial, and resort lands statewide is to the publics benefit. However there is a much simpler way to do this, which is to transfer the statutory language contained in HRS171-92 to a new subsection of HRS171-36 and eliminate HRS171-191 and HRS171-192. HRS171-193 would be incorporated into HRS171-41.6

Please amend and move this bill to the benefit of small businesses throughout the state and to improve the utilization of economic public lands in the public's interest.

Mahalo,

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