



**DEPARTMENT OF
NATURAL RESOURCES**

**OFFICE OF THE
COMMISSIONER OF PUBLIC LANDS**
1111 WASHINGTON ST SE
MS 47001
OLYMPIA, WA 98504-7001

February 6, 2023

The Honorable Bernard Dean
Chief Clerk of the House
338B Legislative Building
Olympia, WA 98504

The Honorable Sarah Bannister
Secretary of the Senate
312 Legislative Building
Olympia, WA 98504

Dear Chief Clerk Dean and Secretary Bannister:

In 2022, the Washington State Legislature amended [RCW 79.13.060](#) through HB 1430 to provide longer terms for specific types of leases from a maximum of 55 years to 99 years. As part of this extension, the statute requires the Department of Natural Resources (DNR) to report to the Office of Financial Management (OFM) and appropriate committees of the legislature within 30 days of the date of execution of the lease. The report must include a financial analysis that justifies the financial benefit for the added term and schedule for periodic rental adjustment.

DNR's Commercial Real Estate staff received a request from one of our commercial lessees in compliance with RCW 79.13.060 (b) (ii and iii). Below is a short summary justifying the financial benefit for the added terms and schedule for periodic rental adjustments.

H&S Associates/Port Orchard

This ground lease was originally entered into on April 15, 1982 and with a 47 year and 3 month term was set to expire on July 14, 2029. A lease extension has been granted for an additional 51 years and 9 months now set to expire on April 14, 2081. This ground lease has retail vacancies that the lessee has not able to fill because they could not offer lease terms beyond July 14, 2029. Tenants were not willing to invest money, time and energy into a space with no option for long-term occupancy. In addition, the landlord (lessee) is not willing to spend money necessary to assist existing or prospective tenants build out or improve space with no long-term assurances of rents to pay back their investment. This ultimately leads to increased vacancies, less revenue, and a deteriorating asset in DNR's portfolio. With the lease extension for another 51 years and 9 months, landlord is able to attract new retail tenants and invest in capital improvements for the building increasing the value of the asset and provide economic growth in the community.

The lease extension will continue to follow the previous terms of the ground lease which already provides for 5 year periodic rental reevaluation and adjustments. The current annual lease rate for H&S Associates, LLC is \$48,806.00 payable quarterly at \$12,201.50 per quarter. Beginning with July 15, 2029, and every 5 years thereafter, the lease rate is to be adjusted by a FMV appraisal using State's appraiser with the new annual rent based upon the then market value of the land only multiplied by the then current capitalization rate which in any event shall not be less than 9% nor less than the previous annual rent.

Should you have any questions, please contact me at 360-486-3469 or Brian.Considine@dnr.wa.gov.

Sincerely,



Brian Considine
Legislative Director
Office of the Commissioner of Public Lands

Enclosed: Third Amendment to Ground Lease (DNR Lease #39-064758)

Cc: House Rural Development, Agriculture, & Natural Resource Committee
Senate Agriculture, Water, Natural Resources, & Parks Committee
Jim Cahill, Senior Budget Assistant, Natural Resources, OFM
Lisa Borkowski, Budget Assistant, Natural Resources, OFM
Brian Considine, Legislative Director, Office of the Commissioner of Public Lands
Todd Welker, Deputy Supervisor, State Lands, Dept. of Natural Resources
Michael Kearney, Division Manager, Product, Sales, and Leasing, Dept. of Natural Resources
Kari Fagerness, Commercial Real Estate Program, Dept. of Natural Resources



HILARY S. FRANZ
COMMISSIONER OF PUBLIC LANDS

DNR Lease #39-064758

THIRD AMENDMENT TO GROUND LEASE

THIS THIRD AMENDMENT TO GROUND LEASE is made this 12 day of January 2023 by and between State of Washington, by its Department of Natural Resources ("State/Lessor"), and H&S Associates, LLC, a Washington limited liability company ("Lessee").

WHEREAS, that certain Ground Lease was entered into by and between the State of Washington, by and through its Department of Natural Resources, as Lessor, and Puget Sound Flooring, Inc., a Washington corporation, as Lessee, dated April 14, 1982, then amended by that First Amendment to Lease dated May 10, 1988, and subsequently leased to First Western Development III Associates, a Washington general partnership by that Ground Lease, also known as the Second Amendment and Restatement of Lease, dated May 22, 1989, and then assigned to H&S Associates by that Lease Assignment dated June 1, 2004 ("Lease"), for that certain real property located at the commonly known address of 2995 Mill Hill Drive, Port Orchard, Washington 98366, as more fully described in the Lease and attached Exhibit A; and

WHEREAS, Lessee desires to extend the Lease term as permitted by and subject to the conditions of RCW 79.13.060, and Lessor is agreeable to these modifications of the Lease, and the parties desire to modify the Lease accordingly;

NOW THEREFORE, in consideration of the covenants and agreements contained herein, the parties hereby mutually agree as follows:

1. Extension Term and Expiration Date: The term of the Lease, as set forth in Section 2 of the Ground Lease shall be amended to extend the term by fifty-one (51) years and nine (9) months, commencing on July 15, 2029 and expiring on the new Expiration Date of April 14, 2081 (the "Extension Term").

2. Annual Rent: Section 3.1. of the Lease is hereby amended to add the following language as new subsection 3.1(d): Commencing on July 15, 2029, and at intervals of five (5) years thereafter, a new annual rental will be established as specified in attached Exhibit B, Rental Adjustment, and by reference incorporated herein.

All other terms and conditions of said Ground Lease shall remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed as of the day and year first written above.

LESSOR

STATE OF WASHINGTON BY THE DEPARTMENT OF
NATURAL RESOURCES

By: Michael Kearney

Its: Division Manager

LESSEE

H&S ASSOCIATES, LLC

By: Michael Hess

Its: Manager

Acknowledgements follow on next pages.

STATE ACKNOWLEDGMENT

STATE OF WASHINGTON)
) ss.
COUNTY OF THURSTON)

I certify that I know or have satisfactory evidence that the person appearing before me and making this acknowledgment is the person whose true signature appears on this document.

On this 12 day of January, 2023, personally appeared before me Michael Kearney, to me known to be the Division Manager for the State of Washington, that he executed the within and foregoing instrument on behalf of the State of Washington, and acknowledged said instrument to be the free and voluntary act and deed of the State of Washington for the uses and purposes therein mentioned, and on oath stated that he was authorized to execute said instrument.

WITNESS my hand and official seal hereto affixed the day and year first above written.

Kelli Pinchak

Notary Public in and for the State of Washington,
residing at 1111 Washington St, Olympia, WA

My commission expires: 10/26/2026
kelli pinchak

[Type or Print Notary Name]



(Use This Space for Notarial Seal Stamp)

LESSEE ACKNOWLEDGMENT

STATE OF WASHINGTON)
) ss.
COUNTY OF THURSTON)

I certify that I know or have satisfactory evidence that the person appearing before me and making this acknowledgment is the person whose true signature appears on this document.

On this 12 day of JANUARY, 2023, before me personally appeared Michael Hess, to me known to be the Manager of H&S Associates, LLC, the company that executed the within and foregoing instrument, and acknowledged the said instrument to be the free and voluntary act and deed of said corporation, for the uses and purposes therein mentioned, and on oath stated that (s)he was authorized to execute said instrument.

WITNESS my hand and official seal hereto affixed the day and year first above written.

KELLI PINCHAK
Notary Public
State of Washington
Commission # 22032957
Commission Expires 10/26/2026

Kelli Pinchak
Notary Public in and for the State of Washington,
residing at 1111 Washington Street, Olympia, WA
My commission expires: 10/26/2026
kelli pinchak
[Type or Print Notary Name]

(Use This Space for Notarial Seal Stamp)

EXHIBIT A

Legal Description

Beginning at the southeast corner of the Southwest quarter of the Southeast quarter of Section 25, Township 24 North, Range 1 East, W.M.; thence North 0 degrees 24' 22" East 58.32 feet to a point on the North margin of State Road No. 14 and the true point of beginning; thence North 0 degrees 24' 22" East along the east line of the said Southwest quarter of the Southeast quarter of the southeast quarter, 300.00 feet; thence North 89 degrees 54' 44" west parallel to the North margin of State Road No. 14, 300.00 feet; thence South 0 degrees 24' 22" West 300.00 feet to the North margin of State Road No. 14; thence South 89 degrees 54' 44" East along the said North margin, 300.00 feet to the point of beginning containing 2.066 acres, more or less.

EXHIBIT B
RENTAL ADJUSTMENT

Beginning on July 15, 2029 the forty-seventh year and 3-month anniversary of the Commencement Date, and at intervals of five (5) years thereafter, a new annual rental will be established (the "Adjustment Date"). Failure on the part of State to establish a new rental on any anniversary of the Commencement Date of this Lease on which adjustment is to be made shall not preclude State from doing so anytime thereafter, and the new rental shall be due retroactive to the Adjustment Date. The new annual rental shall be established by the State using either one of the following two methods selected by State in State's sole and absolute discretion:

METHOD A - CPI With No Maximum.

When the annual rent is to be adjusted based on the CPI, the annual rent shall be the sum computed by increasing the annual rent paid during the prior five (5) year period by the percentage increase in the United States Department of Labor, Bureau of Labor Statistics, "All Items" Consumer Price Index for All Urban Consumers ("CPI"), United States City Average (1982-84=100) from the level of said CPI five years prior to the Adjustment Date to the level of the CPI as of the Adjustment Date, or as a formula:

$$\text{New annual rent} = \text{previous annual rent} \times \frac{(\text{CPI as of Adjustment Date})}{(\text{CPI five years prior to Adjustment Date})}$$

In the event the change in the CPI for such period is a negative value, the annual rent shall in no event be less than the annual rent for the preceding five year period. In the event such price index ceases to be published, the most nearly comparable price index then published by the United States Government shall be substituted in its place. If State and Lessee cannot agree as to a substitute index, then a new index shall be determined through arbitration in accordance with Section 14 above. In the event a computation of an adjustment in the annual rent requires the use of published information which is not available as of the effective date of such rental adjustment, the adjustment shall be determined as soon as practical after the adjustment date, and Lessee shall continue to make periodic rental payments equal to the annual rent previously applicable. Any adjustment in such payments shall be paid by Lessee within thirty (30) days after a determination of the proper adjustment has been made.

METHOD B - Periodic Reappraisal.

When the annual rent is to be adjusted based on appraisal, the new annual rental shall be the appraised fair market value of the Property multiplied by the then current 5-Year Treasury Note Rate plus 275 basis points (5-Year Treasury Note Rate + 2.75%). The term "5-Year Treasury Note Rate" shall mean the interest rate on 5-year promissory notes issued by the United State Treasury, any change in such 5-Year Treasury Note Rate to effect a change in the rate charged hereunder on the date of each such change. If the United States Treasury ceases to issue such 5-year Treasury Notes, then State shall designate another comparable index rate which, in the reasonable opinion of State, represents a comparable financial instrument as the "5-Year Treasury Note Rate" as defined herein.

In no event will the adjusted annual rental be less than the previous annual rental. The fair market value will be determined, exclusive of Lessee's improvements and as though the ownership were in fee simple, by State's appraiser. The fair market value will be established as of the beginning of the rental adjustment period. In the event that agreement cannot be reached between the parties on the fair market value of the Property, such valuation shall be submitted to a panel of three appraisers (qualified as defined in Section 14 above). One

appraiser shall be selected by Lessee and this expense shall be borne by Lessee; one appraiser shall be selected by State and this expense shall be borne by State; these appraisers so selected shall mutually select a third appraiser and such expenses shall be shared equally by Lessee and State. The majority decision of this panel of appraisers shall be binding and conclusive upon State and Lessee. Notwithstanding submission of the evaluation to the appraisers, Lessee shall pay the rental amount as proposed by State on the due dates as required if no decision by the panel of appraisers has been made or if the panel has not yet been formed. If additional payments or refunds are required as a result of this review, such monies shall be due and payable within thirty (30) days after such decision.

On those Adjustment Dates that State notifies Lessee of a rent adjustment based on Method A (CPI index) above, Lessee shall have the right to notify State that Lessee desires that the new Rent be established by appraisal of the Property in accordance with Method B. Lessee must notify State in writing within 5 business days after receipt of State's notification of a rent adjustment. Lessee shall pay the cost of said appraisal and such appraisal shall establish the new annual rent for the next 5-year period. In no event will the adjusted annual rental be less than the previous annual rent.