

REAL PROPERTY LEASES

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FOREWORD

This report has been prepared in response to Senate Concurrent Resolution No. 89, S.D. 1, adopted during the Regular Session of 2003, which requested the Legislative Reference Bureau study major problems facing commercial and other land lessees.

In conducting this study, the Bureau was directed to contact certain individuals and organizations identified in the Resolution and other stakeholders with a direct interest in the issues set forth in the Resolution. Input was obtained by way of questionnaires soliciting information from identified multi-family, commercial and industrial lessors and lessees, and real estate analysts knowledgeable in the area of leasehold issues. The Bureau also obtained information from studies submitted by stakeholders and data contained in the latest available Quarterly Statistical & Economic Report issued by the Department of Business, Economic Development and Tourism.

The Bureau would like to thank all parties who submitted information in response to our questionnaires and also the real estate analysts who responded to our questions.

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Chapter 1

INTRODUCTION

Scope of Study

During the Regular Session of 2003, the Legislature adopted Senate Concurrent Resolution No. 89, S.D. 1 (hereafter "Resolution"), entitled "Requesting a Study on Real Property Leases." (See Appendix A.) The primary direction of the Resolution was "...that the Legislative Reference Bureau is requested to study the major problems still facing commercial and other land lessees...." Further, it requested that the Bureau:

- Consult with certain organizations and individuals "with a direct interest in the issues to ensure that all stakeholders are allowed to express their thoughts and concerns;"
- "Consult with the Attorney General for legal issues, opinions, and advice relating to any constitutional issues related to the study; and"
- "Submit a report of its findings and recommendation, including any proposed legislation, to the Legislature no later than twenty days before the convening of the Regular Session of 2004."

The opening *Whereas* clauses of the Resolution make reference to the perceived problem caused by the "artificially high land values" resulting from intense Japanese investment in Hawaii real estate during the period covering 1985 to 1990, estimated to be as high as \$15,000,000,000. This massive influx of foreign capital inflated land values locally, which were then used as comparables in rent renegotiations for commercial and industrial leasehold properties, resulting in "highly inflated long-term ground leases" throughout the State. The Resolution states that this has led to lessees in many cases downsizing their businesses, reducing employee work hours and benefits, and reducing capital improvements. In many cases, lease rents were unsustainable by the improved properties' economic uses intended under the terms of the leases. Some lessees unable to pay these inflated lease rents were faced with forfeiture of valuable improvements, mortgage foreclosures, and bankruptcy.

In many cases, due to the fact that leases contained a clause that the renegotiated lease rent could not be less than the lease rent of the previous period (the "not less than" clause), the resulting lease rent remained higher than it would have been if the renegotiated lease rent had been based on the lower land values which deflated following the bursting of the "Japanese bubble." The Resolution further found that these inflated lease rents were imposing burdens on many lessees, resulting in adverse impacts upon the Hawaii economy.

The sixth *Whereas* clause of the Resolution made reference to a similar House Concurrent Resolution No. 312, adopted during the Regular Session of 1993, which created a task force to examine this same problem. That earlier task force found some renegotiated commercial lease rent increases in excess of 200%, causing hardships to and the closures of

many local businesses. Ten years later, the Legislature finds that the problems of lessees remain unresolved.

Methodology

The Bureau has neither the personnel nor expertise to undertake a comprehensive empirical fact gathering analysis, nor is it equipped to undertake a definitive economic study. Additionally, the language of the Resolution is very broad and general. To ensure completion in a timely manner, this study is relatively general and policy oriented and limited in scope.

In undertaking this study, the Bureau was directed to consult with certain specified organizations and any individual or agency or organization with a direct interest in the issues to collect their thoughts and concerns. The primary method of consulting with these persons and organizations was through the preparation and dissemination of a questionnaire. However, upon reviewing some of the public testimony presented at the committee hearings on this Resolution, it became apparent that this request for comments was to be sent out to persons and organizations which represented a broad spectrum of opinions on this issue. The interested parties or stakeholders with whom the Bureau was requested to consult ranged from landowners or lessors who did not believe a problem existed, or believed that any problem had been resolved by the passage of time, to lessees who were urging the imposition of rent caps, a one-time rent renegotiation overriding any "not less than" clause in a existing lease, or commercial leasehold reform permitting the forced purchase of the fee interest under their leasehold properties.

Due to the broad different perspectives on the issues, separate questionnaires were prepared and sent out to persons or organizations identified as lessors and persons and organizations identified as lessees (see Appendices B and C). The primary purpose of the questionnaires was to determine the direct effect the Japanese bubble from 1985 to 1990 had on rent renegotiations. A total of fourteen lessor questionnaires were sent out and fifty-six lessee questionnaires were sent out. Appendix D contains a list of all the recipients of the questionnaires. Although the responses were deemed to be confidential, the response rate was low: five questionnaires were received back from lessors and thirteen questionnaires were received back from lessees.

After reviewing a newspaper article on the scarcity of industrial warehouse space,¹ Bureau staff solicited comments on the contents of the Resolution from real estate analysts with the firms of CB Richard Ellis Hawaii, Colliers Monroe Friedlander Inc., and Grubb & Ellis/CBI Inc. to add a different perspective. Finally, staff had various conversations with representatives of both lessors and lessees, real estate appraisal firms, and financial institutions.

Organization

This opening chapter provides the direction and task set forth by Senate Concurrent Resolution No. 89, S.D. 1, the scope of the study, and the methodology utilized in this study. Chapter 2 provides background information regarding past efforts to address the problems faced

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by single-family and multi-family lessees and past attempts to address the problems faced by commercial lessees by past Legislatures and the Council of the City and County of Honolulu. Chapter 3 sets forth an analysis of the responses made to the disseminated questionnaires by lessors and lessees of multi-family leasehold developments and conclusions. Chapter 4 sets forth an analysis of the responses made to the questionnaires by lessors and lessees of commercial and industrial developments and conclusions. Chapter 5 contains the Bureau's recommendations.

ENDNOTES

1. Isle warehouse space is getting scarce, *Honolulu Star-Bulletin*, August 21, 2003.

Chapter 2

BACKGROUND AND PAST LEGISLATION

Single-Family Leasehold Reform

In 1967, in response to ideological forces fighting an oligopolistic land tenure system in Hawaii and spurred on by more practical reasons of increasing lease rents on renegotiations, the State Legislature enacted Act 307, Session Laws of Hawaii 1967, codified as Chapter 516, Hawaii Revised Statutes. Chapter 516, as amended over the years, allows lessees of long-term leasehold interests in single-family residential development tracts the right to purchase the fee interest of their residential lots through a condemnation process involving the fee simple landowner and what is now the Housing and Community Development Corporation of Hawaii. The latter party would condemn the fee interest, paying the fee owner fair compensation for the fee interest and, in turn, sell the acquired fee interest to the leasehold homeowner.

Following extended litigation, in 1984 United States Supreme Court ruled in *Hawaii Housing Authority v. Midkiff*,¹ that Act 307 did not violate the United States Constitution. Shortly thereafter, in *Hawaii Housing Authority v. Lyman*,² the Supreme Court of Hawaii in like manner found that Act 307 did not violate the state Constitution. As a result over the last 25 years, the number of leasehold single-family residences fell from a high of approximately 28,000 to 4,600.³

Multi-Family Leasehold Reform

Following the successful effort in virtually eliminating the single-family leasehold system in Hawaii, many owners of multi-family residential leasehold units facing lease rent renegotiations, including cooperative housing corporations (i.e., "coops"), condominiums and planned development housing, aspired to be able to purchase the fee interests under their multi-family units. Over the years, numerous bills were introduced to extend the right to purchase the fee interest by multi-family unit leasehold owner, culminating in 1991 with two bills introduced in the Legislature proposing mandatory leasehold conversion for multi-family units, or in the alternative, giving the lessor the option of leasehold conversion or lease rent control.⁴

Senate Bill No. 948, reciting many of the findings of Act 307, called for the mandatory condemnation of multi-family units upon the application of 50% of the units in a development. The then Housing Finance and Development Corporation, following a public hearing to assure that a public purpose was being effectuated, would have the parties negotiate an agreed upon value for the fee interest. Absent agreement, the Housing Finance and Development Corporation would determine the value of the fee interest, based upon the final positions of the parties, and would then condemn the fee interest of the development and resell the fee interest to unit owners. Where this bill departed from Act 307 was in the payment to the fee owner upon condemnation. The fee owner would receive only 50% of the fee value for every unit; however, the fee owner would retain a continued interest in the unit. Upon the subsequent sale of the unit by its owner,

the fee owner would receive 13% of the actual sale price or tax assessed value of the whole unit, whichever was higher. Senate Bill No. 948 was referred to the Committee on Housing and Hawaiian Programs and was not reported out for Second Reading in the Senate.

Senate Bill No. 1255 which was also introduced in 1991, recited many of the same findings that were contained in Act 307; however this bill gave the fee owner the option between leasehold conversion or lease rent control. Senate Bill No. 1255 required a threshold of at least twenty-five (or more than 50%, whichever is less) of owner-occupants of a development to apply for conversion. This time, following a public hearing to determine whether a sale would effectuate a public purpose and establishing the value of the fee interest by mutual agreement of the parties or determination by the Housing Finance and Development Corporation, the fee owner had the option to sell the fee interest at the value determined or keep the fee interest, but any increases in rent would be limited to increases in the consumer price index. In the event the fee owner agreed to sell the fee interest, the price the fee owner received was 100% of the agreed upon or determined fee value for each unit, plus an additional share in any appreciation in the value of the fee interest if the unit was sold within twenty years of the conversion. Initially, the lessor would be entitled to all the appreciation, if any, if the unit was sold immediately upon the conversion. The lessor's share of the appreciation would be reduced by 20% for every two years after the conversion until the ninth year. Thereafter, the lessor's share in the appreciation would remain at 10% until the end of the twentieth year.

Senate Bill No. 1255, S.D. 2, crossed over to the House of Representatives where its contents were substituted for those of a similar House Bill No. 1982, H.D. 1 (which had earlier passed out of the House). The bill was passed by the House on Third Reading as Senate Bill No. 1255, S.D. 2, H.D. 1.⁵ The Senate and House conferees could not come to agreement on a final version of the bill in conference during that Regular Session.

However, in 1991, the Honolulu City Council adopted Ordinance 91-95, which granted multi-family residential leaseholders the right to purchase the fee simple interest to their units in a condemnation procedure similar to Chapter 516, Hawaii Revised Statutes. The new ordinance, codified at Chapter 38, Revised Ordinances of Honolulu (hereafter "ROH"), provided that at least twenty-five of all the condominium owners (defined as owner-occupants) or at least owners of 50% of the condominium units within the development, whichever was less, could trigger the condemnation process by the city Department of Housing and Community Development. Following the inevitable court challenge, the United States Ninth Circuit Court of Appeals in *Richardson v. City and County of Honolulu*⁶ held the ordinance did not violate the United States Constitution.

In 2002, in *Coon v. City and County of Honolulu*,⁷ the Hawaii Supreme Court upheld the validity of Chapter 38; however, in so doing, the Court held that rules promulgated to implement Chapter 38, relating to determining the minimum number of applicants required to initiate the conversion process violated Chapter 38 by impermissibly lowering the minimum number of applicants required. In order to trigger a condemnation, §38-2.2(a)(1), ROH requires applications from at least twenty-five condominium owners within the development or at least owners of 50% of the condominium units, whichever number is less. Rules §2-3, promulgated by the city Department of Housing and Community Development (hereafter the "Department")

authorizes the Department to designate a condominium development eligible for condemnation when it receives applications from twenty-five condominium owners by number, or 50% of the condominium owners of a development, whichever is less. Rules §1-2 and §38-2.2 (a)(2), ROH, both define "condominium owners" to mean "owner-occupants," and not all the condominium units in a given development are necessarily owner-occupants. Therefore, while the ordinance required at least twenty-five owner-occupants to trigger a condemnation, the rule simply required 50% of the owner occupants in a condominium development, which could be less than twenty-five in number. This prompted the City Council to attempt to amend Chapter 38 in 2002 by introducing Bill 53, which would bring Chapter 38 in line with the liberal rules for triggering the conversion process, making Chapter 38 as broadly applicable as possible. However, this time the proponents were met by a more organized effort by fee owner lessors seeking to keep the conversion process comparatively narrow by excluding as many multi-family projects as possible from the process established in Chapter 38.

In response to this opposition, Bill 53, after passing Second Reading, was referred back to the Council's Executive Matters Committee where it remains. Instead of moving Bill 53 and continuing public discussion on this matter, the Council passed Resolution 03-69 which established a Leasehold Conversion Task Group. Basically, the mandate of the Task Group was to review Chapter 38 and attempt to identify the issues perceived as unfair by either lessors or lessees and to propose measures to eliminate or mitigate the perceived unfairness. As amended by further resolutions,⁸ the Task Group is now composed of six individuals representing the interest of lessors and six individuals representing the interests of lessees and led by a non-member independent facilitator. The Task Group facilitator is to submit a final report to the Executive Matters Committee within six months of the Task Group's first meeting, which was held on October 2, 2003, followed by a public hearing on October 31, 2003.

Commercial Property Leasehold Conversion

Echoing the same concerns that led to the passage of House Concurrent Resolution No. 312 (Regular Session of 1993) and are recited in Senate Concurrent Resolution No. 89 (Regular Session of 2003), on March 31, 1998, Bill 46 was introduced in the Honolulu City Council calling for commercial leasehold conversion. The bill cited the findings of the concentration of the fee title to commercial property being held by a few private landowners. It further cited the artificially high property values caused by wealthy international investors and the use of those high land values by lessors to calculate master ground lease rents. The bill went on to recite that this situation has resulted in inflation, instability and economic disruptions on Oahu with potentially damaging consequences to all members of the community.

Bill 46 would permit any one lessee who owns a commercial project, including hotels and warehouses, to apply with the city Department of Housing and Community Development to commence a condemnation process similar to Chapter 38, relating to multi-family leasehold units. Bill 46 passed First Reading and was referred to the Committee on Policy on April 8, 1998. The bill was not heard in committee and was subsequently filed for no further consideration on March 31, 2000, pursuant to Section 1-2.4, Revised Ordinances of Honolulu, which sets a filing deadline on pending bills.

Business Leasehold Task Force

As stated in Senate Concurrent Resolution No. 89 (Regular Session of 2003), in 1993, the Legislature adopted House Concurrent Resolution No. 312, entitled "Convening a Task Force to Study the Major Problems Facing Commercial Land Lessees." The focus of the task force was to determine:

- How many acres of land in Honolulu in hotel, commercial and industrial uses were leasehold.
- Whether rents being renegotiated for such uses were economically feasible.
- How many hotel and small businesses were affected by high lease rents.
- Small businesses impact on the stability of the Hawaii economy and tax base.
- Where small businesses may relocate to lands with reasonable rents.
- Whether legislation capping lease rents or requiring the income approach to appraising property was required.

Further, the task force was directed to work with the City and County of Honolulu in overhauling its property value assessment methods.

The task force was comprised of forty-one persons representing a wide range of parties, including small businesses, large landowners, commercial developers, and appraisers. Four public hearings were held on Oahu, one on Maui and one in Hilo. Without reaching a consensus on the issues raised by the Resolution or what to include in any final report, the members of the task force decided on a report format that allowed individual statements by each member, addressing the issues raised by the Resolution. The report closed with five recommendations, each of which, while not reflecting a consensus, was supported by a significant majority of the task force members. Those recommendations from the 1993 task force were as follows:

1. Laws should be enacted to ensure that arbitrators for lease rent renegotiation arbitrations are selected through a double blind process, to ensure neutrality.
2. The Legislature should convene a task force consisting of representatives of lessors, commercial and industrial lessees, and financial institutions to explore methods to establish longer periods of known rents.
3. The general excise tax law should be amended to exempt amounts received by fee owners from business and commercial lessees to pay real property taxes owed to the counties.

4. The Legislature should urge counties to review their tax assessment procedures for conformity with the Uniform Standards of Professional Appraisal Practices.
5. The Legislature should enact legislation to designate the American Arbitration Association to administer arbitration panels to determine the fair market rents at the time of commercial and industrial leasehold rent renegotiations.

While none of the specific recommendations was ever acted upon, in 1998 the Legislature enacted Act 180, Session Laws of Hawaii 1998, codified as Section 466K-4, Hawaii Revised Statutes, which required all real estate appraisers who are licensed or certified to practice in this State to comply with the current uniform standards of professional appraisal practices when performing appraisals in connection with a federally or non-federally related real estate transaction. Ironically, in 1999 the Legislature enacted Act 287, codified as Section 466K-4(b), Hawaii Revised Statutes, which specifically exempted real estate appraisers employed by the counties to value real property for ad valorem taxation from the requirement of complying with the uniform standards of profession appraisal procedures. This was completely contrary to recommendation 4 of the task force.

Related Legislation

During its Regular Session of 2000, the Legislature passed Senate Bill No. 873, S.D. 1, H.D. 2, entitled "A Bill for an Act Relating to Real Estate Appraisals." (See Appendix E.) The purpose of the bill was to amend Chapter 519, Hawaii Revised Statutes, which deals with lease rent renegotiations for both commercial and residential leases. In its final form, Senate Bill No. 873 provided that at the time of any rent renegotiation, if the lease rent renegotiated is based on fair market value and is less than the rent currently being paid, that renegotiated rent will prevail over any existing contract provision that bars the lowering of lease rent upon renegotiation.

Governor Benjamin Cayetano vetoed Senate Bill No. 873, S.D. 1, H.D. 2, declaring that it violated the Contracts Clause in Section 10 of Article I of the United States Constitution. The Governor said that the bill, by attempting to statutorily override the "not less than" clause in a lease contract, was an unconstitutional attempt to impair the obligations of a contract. (See Appendix F for Governor Cayetano's veto Proclamation and Statement of Objections to Senate Bill No. 873.)

In an Attorney General's opinion issued on April 20, 2000 (see Appendix G), which the Governor relied upon in vetoing the bill, the Attorney General stated that the prohibition in the Contracts Clause is not absolute, however, there had to be some limits on the power of the State to abridge existing contractual obligations. In its opinion, the Attorney General quoted from the decision of the Hawaii Supreme Court in *Applications of Herrick & Irish*⁹ as follows:

In deciding whether a state law has violated the federal constitutional prohibition against impairment of contracts, U.S. Const., art. I, §10, cl.1, we must assay the following three criteria: (1) whether the state law operated as a substantial impairment of a contractual relationship; (2) whether the state law was designed to promote a significant and

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legitimate public purpose; and (3) whether the state law was a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose.

The Attorney General noted that the only public policy stated in Senate Bill No. 873, S.D. 1, H.D. 2, was "The legislature finds that it is in the public interest that the lease rent and sublease rent should be based on the fair market value of the land." Not only was the stated purpose insufficient, but the Attorney General pointed out that in the final version of the bill, any savings that a ground lessee received, as a result of proposed changes in the bill, did not pass through from the lessee-sublessor to a sublessee.

In response, the following year, during the Regular Session of 2001, House Bill No. 1131 (see Appendix H) was introduced. In section 1 of the bill, which took up the first four pages of the bill, the authors of the bill cited all of the historic problems stemming from the concentration of fee ownership of land in a small handful of owners and the leasehold system of property tenure in Hawaii. It further recited the artificial inflation of land values due to international investors and the use of these inflated values in determining ground lease rents. While land values have fallen from the inflated heights, according to the bill, lease rents remain higher than present fair market value can support, due to the "not less than" clause in many lease contracts, thereby negatively impacting the entire State economy.

House Bill No. 1131, H.D. 1, which provided that a lease rent based on fair market value determined by appraisal that is less than the lease rent currently being paid shall prevail over any existing contract provision that bars the lowering of lease rent upon renegotiation, passed out of the House but was not reported out of the Senate Committee on Commerce, Consumer Protection and Housing. (Apparently, the Chairman of the committee relied upon another opinion by the Attorney General, dated March 22, 2001, which basically reiterated its earlier opinion that this bill violated the Contracts Clause by substantially impairing contractual rights and obligations without furthering a significant public purpose by reasonable and narrowly drawn means. See Appendix I.)

Not to be deterred, proponents of commercial leasehold relief returned in 2002 in support of House Bill No. 2245. Basically, the same findings and purpose contained in the previous bill calling for commercial leasehold relief were recited in section 1, this time covering the first eight pages of the bill and also citing the negative impacts on the State's economy caused by the terrorist attack of September 11, 2001. In its final form, House Bill No. 2245, H.D. 1, S.D. 1 (see Appendix J) provided that, notwithstanding existing lease provisions, any lease that had its lease rent renegotiated after January 1, 1990, shall be allowed a one-time adjustment at the option of the lessee to reflect present fair market value. This "one-time correction"¹⁰ was to prevail over any existing contract provision to the contrary. Any one-time reduction in ground lease rent to a lessee/sublessor was to be passed on to any existing sublessee. Further, fair market values were to be derived by the use of uniform standards of professional appraisal practice.

House Bill No. 2245, H.D. 1, S.D. 1 made it to a Conference Committee; however, another Attorney General's opinion, dated April 11, 2002 (see Appendix K), found that this bill also resulted in an unconstitutional impairment of contractual obligations and relationships. The bill was not reported out of Conference Committee.

Again in 2003, proponents of leasehold relief refitted House Bill No. 2245, this time in the form of Senate Bill No. 905 (see Appendix L). In its latest metamorphosis, the bill cited findings covering the first eleven pages of the bill, expanding on previous descriptions of the inherent problems facing lessees and the resultant negative impacts to the State's economy. Senate Bill No. 905 again called for a one-time correction in lease rents to prevail over any existing contract provisions and required the passing down of any reduction in ground lease rent to any sublessee. However, new provisions in the bill: made the one-time correction apply only to leases that were in effect on January 1, 1985, and had a rent renegotiation subsequent to January 1, 1990; did not permit the one-time corrected lease rent to be lower than the lease rent prior to January 1, 1985; and had a "drop dead" clause automatically repealing it on December 31, 2006 or three years after a final court decision upholding its validity, whichever occurs later. An almost identical bill, except for the findings and purpose language in the first section and some minor other differences was also introduced as Senate Bill No. 903.

Both Senate Bill No. 903 and Senate Bill No. 905 were referred to the Senate Committee on Commerce, Consumer Affairs and Housing where they have not been heard and remain carried over to the 2004 Regular Session. Instead, Senate Concurrent Resolution No. 89, S.D. 1, that called for the subject study was reported out of the Committee on Commerce, Consumer Affairs and Housing, adopted in the Senate and later adopted in the House without amendment.

ENDNOTES

1. *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984).
2. *Hawaii Housing Authority v. Lyman*, 68 Haw. 55 (1985).
3. For an analysis of the history of single-family leasehold housing in Hawaii, see Sumner J. La Croix, James Mak and Louis A. Rose, "Single Family Leasehold Housing in Hawaii: An Analysis of its Rise and Fall," Working Paper No. 93-13, July 23, 1993.
4. Senate Bills Nos. 948 and 1255, Regular Session of 1991.
5. House Journal, Regular Session of 1991, page 1278. For purposes of economy, since Senate Bill No. 1255 in all its drafts exceeded 90 pages, it, along with Senate Bill No. 948, was not included in the appendices.
6. *Richardson v. City and County of Honolulu*, 124 P.3d 1150 (1997), cert. den. 525 U.S. 871 (1998).
7. *Coon v. City and County of Honolulu*, 98 Haw. 233 (2002).
8. City Council Resolution 03-244 and 03-278.
9. *Applications of Herrick & Irish*, 82 Haw. 329, 340 (1996).
10. House Bill No. 2245, H.D. 1, S.D. 1, Regular Session of 2002, p. 11, line 5.

Chapter 3

RESIDENTIAL LEASEHOLD QUESTIONNAIRE ANALYSIS

Multi-Family Residential

The Bureau received only two responses to the questionnaire relating to multi-family residential leases. One response came from a ground lessor for one single project and the other response was from a representative of residential lessees covering three separate projects. All the projects were located in urban Honolulu. Of the four projects, three were cooperative housing projects with leases that were entered into in the late 1950s and the fourth was a residential condominium project with a lease that was entered into in the late 1960s. Two leases were ground leases and two were ground subleases. The initial fixed rent terms varied from twenty to thirty years. Three of the leases had a fixed step-up rent increase half way through the initial fixed rent term, varying from 15% to 30%. The fourth lease, which was also the oldest, had one initial twenty-year term without any increase and the lowest initial lease rent.

In this essentially retrospective review, the most glaring common fact in the four leases is the low front-end lease rents. The lowest rent started at \$10 per month and the highest (and also the latest lease) at \$23 per month. (While the questionnaire did not specifically request that average apartment lease rents be provided, we assume for the study that the responses referred to average lease rents per multi-unit projects.) Accordingly, an original lessee in the oldest and least expensive leasehold project paid a total of \$2,400 in lease rent for the first twenty years of the lease. The most expensive lease started at \$20 per month with a 15% step-up in rent after the first ten-year term for another ten years, paying a total lease rent for the first twenty years of \$5,160.

The first rent renegotiation for each of the four projects took place in 1982, 1984, 1989 and 1992, respectively. With the Japanese bubble phenomenon extending from 1985 to 1990, only the 1989 renegotiation took place during that period. Due to the low front-end lease rents prior to renegotiation and the land value inflationary period during the 1960s, 1970s, and 1980s, perhaps it could have been anticipated that the renegotiated increases in rent could range from 946% to 4,150%.¹ The highest jump not surprisingly was in the increase of the lease rent of \$10 per month for the first twenty-year term to a new renegotiated rent of \$415 per month.

What was interesting is that the renegotiation that took place in 1989, in the midst of the Japanese bubble, had the lowest percent increase of the four projects. Two of the other renegotiations took place before the bubble period and the fourth took place two years after the bubble. Outwardly, it would appear that the Japanese bubble had no effect upon these rent renegotiations. However, there may have been some lingering evidence of the Japanese bubble.

All four leases have now gone through a second rent renegotiation. The first project to renegotiate for the second time, in 1999, saw a 40%, or 4% per year, increase for the next ten-year period. The last project to renegotiate the second time, in 2002, saw a 42% reduction in its lease rents. The other two projects which renegotiated for the second time, in 1992 and 1994

respectively, had their rents remain unchanged. Unlike the project that last renegotiated for the second time, the latter two projects contained a clause that did not permit the new renegotiated lease rent to be less than the rent for the previous term (the "not less than" clause). Accordingly, between 1992 and 2002, the project last to renegotiate a second time saw a reduction in its underlying land value of 42%. Without further facts, it is uncertain whether that project faced special or different circumstances than the other two projects that entered into their second renegotiations in 1992 and 1994 or whether those two projects would have benefited by the "burst" of the Japanese bubble had it not been for the "not less than" clause in their leases.

At any rate, other questions were raised by the responses to the questionnaires which are beyond the scope of this study. First, of the four leases in question, two are ground leases and two are ground subleases. With regard to the ground subleases, is there a "sandwich" position, some party with a financial interest, who is reaping a benefit at the expense of the lessees paying the lease rents?

Another question relates to the low front-end lease rents. While the equities at first glance would appear to lean to the landowner lessor accepting low front-end rents, perhaps to stimulate the sales of the multi-family units, did the lessors receive any kind of a premium, either an upfront cash premium or, as was typical in many cases, an in-kind premium of a dwelling unit within the finished development from the developer?

ENDNOTES

1. Sumner J. La Croix, James Mak and Louis A. Rose, "Single Family Leasehold Housing in Hawaii: An Analysis of its Rise and Fall," Working Paper No. 93-13, July 23, 1993, p. 27, footnote 74. The authors state that price appreciation on land was unavailable; however, single-family home appreciation provides indirect evidence of high per year increases. Further, note that this survey addressed single-family and not multi-family units.

Chapter 4

COMMERCIAL LEASEHOLD QUESTIONNAIRE ANALYSIS

Introduction

A total of eighteen responses were received by lessors and lessees of commercial or industrial properties. Five of the responses were from lessors and thirteen responses were from lessees. Of the responses from lessees, two involved ground leases by a single lessee/user while the other responses involved ground leases of commercial retail or office developments which in turn were sublet to space sublessees. With the exception of one lessor with land holdings on three different islands, the responders were all located on Oahu.

In response to inquiries arising from an article on industrial property vacancy rates, two responses were received from real estate analysts of real estate firms in Honolulu. In addition to the questionnaire responses, information and data were received from lessees relating to the scarcity of fee simple commercial and industrial properties in the City and County of Honolulu. From the other side, an economic impact report provided by a lessor addresses some of the claims and statements contained in Senate Concurrent Resolution No. 89, S.D. 1. Finally, information from the latest *Quarterly Statistical & Economic Report, Executive Summary*, issued by the Department of Business, Economic Development and Tourism in September 2003 is reviewed.

In separate parts in this chapter, we will analyze the questionnaire responses from lessors and the responses from lessees, and the information provided by the real estate analysts. We will then address the information provided relating to the scarcity of available fee simple commercial and industrial land in Honolulu and the findings of the economic impact report.

Analysis of Lessor Responses

Of the five lessors that responded to the questionnaire, two were large landowners with extensive land holdings in industrial and commercial properties. Another lessor was more oriented to commercial space renting on short-term leases, while the remaining two were generally owners of improved commercial properties under long-term leases.

All lessors indicated that vacancy rates they were experiencing were very low, ranging from 1% to 5%. However, in response to a question as to whether they anticipated applying for land entitlements for the further development of more commercial and industrial land, three of the lessors indicated plans for such expansion. One large landowner lessor indicated that further expansion in industrial properties would probably be sold in fee simple rather than leased. Another lessor planned future development of commercial and industrial lands but indicated that, in keeping with its present operations, the additions would be leased on short-term space leases rather than long-term ground leases. The other two lessors, while recognizing the demand for commercial and industrial land, had no present plans for expansion. One lessor cited the high

costs to construct new facilities in contrast to what it considered modest ground lease rents and space rents for reasons not to move forward with further development.

One of the lessors operated primarily with relative short-term space leases. In this case, the typical leases extended from two to five years with annual or biennial rent increases. The rent step-ups ranged from 2% to 5% or were tied to the consumer price index.

The lessors leasing land on long-term ground leases stated that the leases generally ranged from thirty-five to fifty-five years, with a fixed rent for the first ten to twenty years. Thereafter, rents were renegotiated on the basis of the fair market value of the unencumbered land multiplied by a rate of return of between 6% and 8%. Lease rents increased substantially on those ground leases that began in the 1960s and 1970s, with leases entered into in the 1980s experiencing lesser increases. In recent years, lease rents have remained the same or, in some cases, have been reduced.

One lessor indicated that between 1961 and 1998 its rents increased at an average rate of 790% for the thirty-seven-year period. However, it also reported that its real property tax assessments increased at an average rate of 1,077% for the same period. On the first renegotiated rent period, average rents increased 100%; however, real property tax assessments increased by an average of 150%. Another lessor also stated that average increases in renegotiated lease rents were less than average increases in real property tax assessments.

With regard to the "not less than" clause, most lessors reported that their leases contained such a clause. A standard response was that the clause was mutually agreed to by the lessor and lessee. One lessor responded that the lessor's costs of doing business, *e.g.*, debt service, taxes, maintenance costs, and employee wages and health benefits, never go down, so the lessor cannot afford to have its lease rent income go down. On the other hand, most of the lessors acknowledged the flat economy of the recent past and expressed a willingness to work with their lessees. In some cases, lessors claimed to have granted rent rebates and future reductions of lease rents to retain good lessees.

Not surprisingly, all the lessors spoke up emphatically and unanimously in response to the last two questions in the lessor questionnaire relating to any prevalent problem in the commercial leasehold industry and the need for legislative action. The responding lessors felt that if there was any prevalent problem in the commercial leasehold system, it is a misunderstanding that the lessors are the sole beneficiaries of the commercial leasehold system at the expense of their lessees. In business, there are always risks which any good businessperson will realize, anticipate and formulate contingent plans against. All commercial lease contracts are mutually negotiated and entered into by experienced lessors and lessees. Lessors point out that no lessee is forced into a lease agreement.

The lessors all point out that, particularly with long-term ground leases, the lessees are the beneficiaries of low-fixed front-end lease rents. In both commercial and industrial leases many times the lessee will create a "sandwich position" by subletting space leases to sublessees in excess of the ground lease rent, thereby enjoying an income stream in which the lessor does not normally participate. Further, the lessors point out that, in many commercial lease situations,

the lessee/sublessor will collect an additional rent in the form of a percentage rent that is tied to the sublessee's gross sales. Again, the lessor does not participate in this percentage rent and is left with a low fixed front-end lease rent.

According to the lessors, during this period of low fixed front end lease rents, while the lessee was enjoying the benefits of the ground lease, a prudent lessee should have anticipated that real estate values would increase and should have set aside a reasonable reserve in the same manner that the lessee would for the replacement or renovation of improvements. (The same point could be made in the case of multi-family leasehold situations, particularly in the case of cooperative housing corporations. A prudent board of directors could have set aside a rent reserve in the same manner that it would for capital maintenance and improvements.)

Additional benefits that the commercial or industrial lessees enjoy include the preservation of capital by not having to invest in a fee simple acquisition, thereby freeing up capital for investment in the business rather than in non-income producing real estate. Further, the lessors point out that a ground lease provides the lessee with flexibility, allowing businesses to change their land requirements without the need to sell or dispose of an illiquid asset as the demands for capital, space and other business needs change.

With regard to the need for any legislative action, again as anticipated, the lessors responded emphatically and unanimously in the negative. All lessors agreed that government should not interfere in private mutually agreed to contractual arrangements. Market forces and not government action should prevail. Aberrations in the market place, such as the Japanese bubble, can be and have been met through existing legal processes, including negotiations, arbitration and mediation. Further, since the United States Constitution, as was repeatedly pointed out by the State Attorney General, does not permit the passage of laws impairing the obligations of contracts, any new legislation must be prospectively applied. Finally, any legislative action in this field could undermine the foundations of business and eliminate any incentive for future long-term and substantial capital investment in Hawaii.

Analysis of Lessee Responses

Of the thirteen responses from lessees, two appeared to be from ground lessees who are actually occupying and using the leased premises, while the remaining eleven are from ground lessees of commercial developments who in turn sublease space to commercial sublessee/tenants.

Of the lessees who are in a direct lease and actually using the leased premises, one lease is for a term of twenty-five years, commencing in 1996, with the first five years at a fixed rent, the next ten years with 3% per year step-ups in rent, with the final ten years rent to be renegotiated in the year 2012. With a renegotiation period in 2012, the Japanese bubble would appear to be of no relevance in this case; however, the lessee claims that its present fixed rent with step-ups starting in 1996 reflected a lingering Japanese bubble effect on real estate valuations.

A second direct lessee user of industrial property had a fifty-year lease commencing in 1982, with rent fixed for the first ten years and renegotiated in 1993. The rent increased by 130% on renegotiation; upon appeal to the landlord, the rent was reduced by approximately 17% in the eighth year of the first ten-year renegotiated period. The lessee claimed that the lingering Japanese bubble effect affected its renegotiation in 1993. This lease does not have a "not less than" clause, and conceivably could be reduced even further during the second renegotiation presently taking place.

The other eleven lessee responses were from lessees of commercial retail and office developments that, in turn, sublet space in the leased premises to sublessees. However, two of these lessee responses differed from the remaining nine. The first of these leases was unusual in that, although the term of the lease, commencing in 1986, is for sixty-three years, the lease rent for the entire term of the lease is determined by an agreed upon rent step-up schedule. The step-ups during the first twenty-three years of the lease vary from 14% up to 50%, with the last forty years having step-ups of 20% every five years or four percentage points per year. While the initial term of the lease commenced in the midst of the Japanese bubble years, no comment is made by this lessee of the Japanese bubble effect on setting the initial lease rents. However, the lessee does express concern over the 20% step-ups every five years commencing 2009. It should be noted that this particular development was initially developed by another lessee and the present lessee is an assignee of the lease who presumably purchased it fully aware of its terms.

Another of these lessee responses related to the ground lease of a retail shopping center, which initially set a fixed minimum lease rent versus 10% of the gross lease rents collected from sublessees. However, this lease was renegotiated in 1991, removing the 10% of gross lease rents provision and setting a fixed step-up schedule for the first thirty-five years of the amended lease, with the step-ups averaging 3% per year then up to 6% per year during the last ten-year fixed rent period. The first renegotiation in this amended lease takes place in 2017. While the lease was amended in 1991 to remove the 10% of gross provision and established fixed rents until 2017, no complaint is raised of any Japanese bubble effect inflating the negotiated new fixed rents.

The remaining nine responding lessees had leases that had similar structures. The leases ranged from fifty to sixty-five-year terms, commencing between 1968 and 1989. Many of the leases had an initial one- or two-year development period with a low rent, allowing the lessee to either develop or renovate the retail property and build up tenancies. Following the development period, all the leases had front end fixed lease rents for periods ranging from twenty to twenty-five years; some lease rents remained the same for the entire period and about half had a step-up in rent of 20% to 100% for the last half of the fixed rent period.

Lease rent renegotiations occurred starting in 1989 and through the early 1990s. All lessees encountered substantial increases in lease rents upon renegotiation based on a prevailing return on the fair market value of the subject property. The increases in the renegotiated lease rents ranged from 150% to 1400%. However, in spite of the bulk of the renegotiations taking place in the early 1990s, with one exception, none of the responding lessees blamed any lingering effects of the Japanese bubble for the substantial increases.

Most of these leases had a "not less than" clause and some have already gone through their second renegotiation, experiencing modest increases for the second renegotiated period. However, in one lease without the clause, the lessee received a 20% reduction in the lease rent. Another lessee received a reduction of about 33% in lease rent because, astutely, the lessee negotiated a "not less than" clause for the new lease rent to be not less than the *last fixed rent* rather than the just prior renegotiated rent.

With the majority of these remaining nine leases already through one renegotiating period, all the lessees claim that their lease rent costs have risen at a much higher rate than their other costs of doing business. They cite their lease rent cost at between 14% and 66% of their total costs of doing business, with most in the 50% range.

In response to a question as to any prevalent problem in the commercial leasehold system, again with one exception, none of the responding lessees raised the problem of the Japanese bubble effect. Most lessees raised the fact that there was an oligopoly of a few landowners that owned and controlled the bulk of the commercial and industrial zoned land on Oahu. A common complaint was the lack of fee simple land being available for purchase. Further, due to the dearth of fee simple transactions, the few comparables that are available for use in renegotiating lease rents are inflated. In fact, one lessee pointed out that, due to the few transactions in one part of Oahu, the only comparables available in renegotiating its lease rent were other properties owned by the same lessor.

Most responding lessees urged the passage of legislation calling for commercial leasehold reform, permitting them to purchase the fee simple interest of the lands they are presently leasing, similar to Act 307 benefiting single-family homeowners and Ordinance 91-95, benefiting multi-family homeowners. In the alternative, they urge the passage of legislation permitting the one-time reopening and renegotiating of lease rents, a "not less than" clause notwithstanding (Senate Bill No. 903, introduced in the Regular Session of 2003).

Real Estate Analysts Responses

Following a review of a newspaper article relating to the extremely low vacancy rates of industrial properties (the article cited industrial space vacancy rates at between 2.5% and 4.5% and dropping),¹ inquiries were made to the real estate analysts that were quoted in the article as to whether the present situation with the scarcity of available industrial space was in any way attributable to the Japanese bubble.

Both analysts that replied felt that the Japanese bubble had minimal, if any, effect on the present real estate situation. While the Japanese bubble did raise land values in the late 1980s, it burst in 1990, and over time, land values have returned to normal rational levels, levels that are appropriate to today's real estate markets.

The main cause of the lack of industrial properties and the climbing of industrial lease rents is the lack of supply of desirable near town industrial properties. While rents are climbing, they are not yet at a level that would encourage the development of more industrial properties.

Further, much of the existing industrial inventory is old, dilapidated, and in need of renovation or redevelopment. Lease rents would have to increase significantly higher to allow landowners a reasonable return on any investment in developing new or renovating existing industrial space.

City and County of Honolulu Real Property Tax Data

A review of some of the data gleaned from the real property tax records of the City and County of Honolulu would appear to support the view that land holdings, especially leasehold land, is concentrated in a small handful of owners.² (For report containing data see Appendix M.)

Abstracting the number of parcels on Oahu that are designated for commercial or industrial use for real property tax purposes, the report shows that, for all parcels, so designated, 1,657 or 50.2% are held in fee simple and 1,647 or 49.8% are subject to a lease.³ Taking a sub-market of Oahu, less Wahiawa, the entire North Shore or Koolauloa, and the Leeward or Waianae district, the percent of fee simple to leasehold switches slightly with 49.7% held in fee simple and 50.3% in leasehold. Accordingly, about one-half of all commercial and industrial designated parcels are held in fee simple and half under a lease.

Looking at the ownership of the commercial and industrial parcels in the sub-market described above, in total, the five largest landowners control 38.79% of such parcels; however, looking only at those so designated parcels under leasehold, the top five landowners control 73.83% of all leasehold commercial and industrial designated parcels. (A single landowner -- the State of Hawaii -- is the largest landowner of leasehold parcels with 49.88% ownership, leaving 23.95% to the next four largest private landowners. On a square foot basis, the top five landowners own 76.44% of all leasehold commercial and industrial designated land in this sub-market. However, on a square foot basis, 64.8% of this leasehold land is owned by a private landowner, with the State of Hawaii owning 11.7% of this leasehold land.)

Looking at commercial and industrial designated parcels in smaller sub-markets, the ownership of leasehold parcels become more concentrated. A review of land tenure in tax Zone 1-1 which includes the Moanalua, Mapunapuna, and airport areas shows that the commercial and industrial designated parcels are held 44% in fee simple and 56% in leasehold. However, the top five landowners of leasehold parcels control 79.64% of those leasehold parcels (again, however, the State of Hawaii owns 60.49% of those parcels leaving only 19.15% to the next four largest landowners. On a square foot basis, the top five landowners own 82.43% of all leasehold commercial and industrial designated land in this sub-market, with the State of Hawaii owning 43.19% of this leasehold land.)

Looking at Zone 1-4, which includes the Windward communities of Kaneohe, Kailua and Waimanalo, of all commercial and industrial designated parcels, 37.1% are held in fee simple and 62.9% in leasehold. The top five landowners of the leasehold parcels in this sub-market control 83.93% of those leasehold parcels (this time, without the State being among the top five landowners. On a square foot basis, the top five landowners own 92.95% of all leasehold

commercial and industrial designated land in this sub-market, this time with the City and County of Honolulu owning 51.94% of this leasehold land. While the City did not own many separate parcels, it owns a substantial portion of the total square footage in this sub-market.)

Similarly, looking at Zone 1-9, which includes the Ewa district, including the communities of Aiea, Pearl City, Waipio, Kapolei and Ewa Beach, of all parcels designated for commercial or industrial use, 69.2% are held in fee and 30.8% are in leasehold. The top five landowners of all the leasehold parcels in this sub-market control 84.94% of those parcels (again, without the State among the top five landowners. On a square foot basis, the top five landowners own 95.07% of all the commercial and industrial designated land in this sub-market, with neither the State or City owning any substantial portion of the land in this sub-market.)

In summary, the City data supports the position held by many lessees regarding a concentration of leasehold commercial and industrial properties owned and controlled by a small handful of landowners. Roughly half of all commercial and industrial parcels in Honolulu are held in leasehold, and of those leasehold commercial and industrial parcels, ownership is concentrated in the hands of a few large landowners, including the State of Hawaii.

Economic Impact Report

In response to our questionnaire, one lessor submitted an *Economic Impact Report on Commercial and Industrial Lease Rent Issues*, prepared by SMS, dated October 2003 (see Appendix N). The SMS study addressed the following claims contained in Senate Concurrent Resolution No. 89:

- Hawaii businesses are suffering, and as a consequence are cutting employment and capital expenditures.
- Hawaii businesses are failing at high rates.
- Ground rents have risen at disproportionately high rates, leading lessees to pay an exorbitant share of their revenues for lease rents.
- Lease rents are at levels that cannot be supported by the "economic uses" of the properties.

The scope of the report was to assess the above claims and determine whether the leasehold system in commercial and industrial properties had general impacts on the State's economy. The study utilized data that was generally available to the public.

With regard to employment, the report cited data indicating that locally wages have been growing at rates well above inflation. Further, Hawaii's unemployment rate remains well below the United States' average.

The data further found that bankruptcies in Hawaii were substantially lower than the national average. Bankruptcy filings in Hawaii have declined since 1998, and continue to decline. At the same time, business bankruptcy filings have declined since 1998. On the other hand, business expectations and confidence appear to be on the rise.

Broadly, lease rents for industrial and office space declined during the 1990s; however, they have since increased to levels circa 1990, but with inflation factored in, they remain at about 60% to 65% of 1990 levels. Further, upon reviewing the costs of doing business in Hawaii, the study determined in contrast to the responses to our questionnaire by lessees, that lease rents did not appear to be a major cost component for businesses in the State. The data cited indicated that the rise in lease rents was at a slower rate than inflation or the rise in real property taxes.

In response to the last claim made in the Resolution, the report retorts that, if lease rental were not supportable, leased spaces would be empty, which they are not. Industrial, office and retail space vacancies remain low, which means businesses are sustaining existing lease rents.

In closing, the SMS report responds to the call for leasehold reform for commercial and industrial properties by stating, "Although Hawaii is often characterized as unfriendly to business, it still offers a stable economic and legal setting for investors. If, however, it appears that existing and future commercial contracts can be revised by legislative fiat, rather than negotiations by the contracting parties, the investment climate is far less stable."⁴

A review of the latest *Quarterly Statistical & Economic Report, Executive Summary*, issued by the Department of Business, Economic Development & Tourism in September 2003, supports many of the findings in the economic study.⁵

Some of the conclusions in the executive summary are:

- "Hawaii's economy is doing relatively well. It continues to be helped through otherwise slow times by strong investment in construction and real estate. Hawaii is currently among the leading states in personal income growth and is below the national average in unemployment."⁶
- "Hawaii's civilian employment grew at a strong 4.0 percent growth rate in the second quarter of 2003 or 22,150 more persons employed than in the second quarter of 2002...(while) the unemployment rate declined from 4.4 percent to 4.0 percent from the second quarter of 2002 to the second quarter of 2003 (cite omitted)."⁷
- "Personal income continued to grow at a strongly positive rate during the first quarter of 2003 (the period for which the latest data are available from the Bureau of Economic Analysis) measured over the first quarter of 2002."⁸
- "The number of visitors arriving by air was down 4.7 percent in the second quarter of 2003 from the second quarter of 2002...(however) Hotel occupancy rates rose 0.1 percentage point from 67.5 percent in the second quarter of 2002 to 67.6 percent in the second quarter of 2003 (cite omitted)."⁹

- "Indicators of Hawaii construction industry activity was mostly positive for the second quarter of 2003...The contracting tax base, which measures construction activity subject to the general excise tax, increased by 11.2 percent from the second quarter of 2002 to the second quarter of 2003 (cite omitted)...The value of residential building permit authorizations was up 40.5 percent statewide for the second quarter of 2003 (cite omitted)...Wage and salary jobs in the construction industry increased statewide in the second quarter compared to 2002. Construction jobs were up about 7.6 percent from the second quarter of 2002 to the second quarter of 2003 (cite omitted)."¹⁰
- "The total number of (Hawaii) bankruptcy filing decreased by 6.4 percent in the second quarter of 2003 compared to the second quarter of 2002 (cite omitted)."¹¹

ENDNOTES

1. "Isle Warehouse Space Is Getting Scarce, *Honolulu Star-Bulletin*, August 21, 2003.
2. The data referred to is contained in a report *entitled The Concentration of Land Ownership on Oahu, Relative to Fee Simple and Leasehold Tenancy*, prepared by Data@Work, dated November 15, 2003.
3. It should be noted that these numbers refer to separate parcels of land for real property tax purposes, and do not indicate acreage or square footage. In later paragraphs of this part, there will be separate references to square footage.
4. *Id.* at p.13.
5. Quarterly Statistical & Economic Report, Executive Summary, September 2003, (<http://www.hawaii.gov/dbedt/qser/index.html>).
6. *Id.* at p. 3.
7. *Id.* at p. 12.
8. *Id.* at p.14.
9. *Id.* at p. 19.
10. *Id.* at p. 22.
11. *Id.* at p. 25.

Chapter 5

CONCLUDING OBSERVATIONS

Senate Concurrent Resolution No. 89, S.D. 1 (2003), requested that the Bureau to study problems facing lessees. The Bureau sent out questionnaires to various lessees and lessors of multi-family residential leaseholds and commercial leaseholds, and also reviewed information from real estate analysts who agreed to assist the Bureau, real property tax data from the City and County of Honolulu, an economic report prepared by SMS research, and the latest Quarterly Statistical & Economic Report prepared by the Department of Business, Economic Development and Tourism.

1. With respect to multi-family residential leaseholds, as a practical matter, the most active arena at present is the Honolulu City Council, which has established a Task Group that includes many interested parties on both sides of the issue of multi-family leasehold conversion.¹
2. The primary question being debated by the Task Group members concerns the number of owner-occupants or total multi-family units in a development that should be necessary to trigger the residential leasehold conversion process under the county's ordinance. The lessees want to lower the required threshold, thereby potentially enabling more multi-family projects to convert to fee simple. Conversely the lessors want to require a higher threshold, which would more strictly limit the number of qualifying projects.
3. At the same time, lessee proponents will almost certainly continue in their efforts at the Legislature to enact a law authorizing one-time renegotiation of lease rent, whether or not the lease contains a "not less than" clause that prevents a renegotiated lease rent from being lower than a pre-set level. The intent of the statutorily mandated renegotiation is to offset the perceived effect of the Japanese "bubble" that lessees contend raised real property prices in Hawaii to artificial levels with a corresponding impact on lease rents. This could benefit the lessees of certain multi-family units. Lessors contend, however, that with the passage of time, even these perceived inequities may be removed if real estate values continue to appreciate. As the recent low interest rates have pushed new and resale purchases of single-family and multi-family units to greater heights, the value of the underlying fee simple property may similarly continue to increase.² If this holds true, lessors believe that the "not less than" clauses may become irrelevant in future lease rent renegotiations.
4. With respect to commercial and industrial leaseholds, the responses received from lessors, lessees and the real estate analysts consulted, indicate that while the Japanese "bubble" may have negatively impacted the leasehold system in the past, it presently appears to have minimal, if any, continuing effect. While the majority of lessee responses cited the "not less than" clauses as the main problem in their

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leases, none claimed the Japanese bubble effect as a major problem in a rent renegotiation, although two lessees claimed it had an effect on the determination of the initial lease rent charged in their leases. However, while some lingering effect of the "bubble" may remain, as evidenced by the two commercial leasehold examples discussed in a previous chapter where commercial lease rents were reduced upon a second renegotiation, even this lingering effect will probably be removed if the real estate market continues to improve.

5. According to the real estate analysts and the SMS economic study, lease rents are probably "right where they should be". In fact, with regard to industrial properties and the present low vacancy rate, lease rents are going up but will have to climb significantly before justifying investment for the development of additions to and renovation of existing inventory.
6. According to the SMS economic impact study, lease rents are not a major component of doing business in Hawaii. This is, however directly contradicted by the responses received from some lessees who reported that their lease rents were in excess of 50% of their costs of doing business. Only a small percentage of questionnaires mailed to lessees were returned. It is possible that lessees who are being substantially impacted by lease rents in the operation of their business were more inclined to respond. However, there can be no doubt that at least some lessees find their present lease rents to be a heavy burden.
7. According to real property tax data from the City and County of Honolulu, in certain areas of Oahu, a small handful of large landowners (including in some cases the State and the City), control a high concentration of commercial and industrial leasehold properties. This has caused, according to some of the lessee responses, problems in renegotiating lease rents due to the shortage of comparable fee simple transactions to use to establish fair market values.
8. There is no question that there are lessees who are being heavily impacted by the leasehold tenure system in commercial and industrial properties. However, indications from the Department of Business, Economic Development and Tourism (DBEDT) are that overall, business in Hawaii appears healthy at this time.³ According to DBEDT, recent private sector construction activity, particularly in single-family and multi-family construction, projected federal spending for improving military facilities, and a rebounding visitor industry following the Iraq hostilities and the SARs epidemic all point to a positive future business environment for Hawaii.
9. One of the main problems that lessee responses cited in their existing leases was the presence of "not less than" clause. Over the last several years, many attempts were made by lessees to enact legislation that would have the effect of altering various terms of existing lease agreements. These attempts received varying degrees of support from legislators. However, most of these attempts have failed in the past as a result of State Attorney General opinions that the bills violated the provision of

the United States Constitution clause prohibiting the impairment of contracts. While it is clear that certain lessees are experiencing significant difficulties under their present leases, there is no indication at this time of a broad based compelling need for the Legislature to pass legislation to mandate the alteration of existing lease agreements.

10. The final (and by no means profound) conclusion to be drawn from the responses to the questionnaires, the responses from the real estate analysts, and the other information received is the lack of available fee simple commercial and industrial property on the market. Whether the situation is attributed to the leasehold system, the land entitlement system, or simple geography, the primary problem lessees face tends to stem from supply and demand. There simply is not enough commercial and industrial zoned land, fee simple and leasehold, in the market place.

Whether or not the Legislature chooses to assist lessees by passing legislation to mandate the alteration of existing lease agreements, the Legislature may want to consider taking steps to make more fee simple property available for commercial or industrial use. None of the items discussed below are "simple", "easy", or "free". At the very least, most will require extensive discussion, investigation, planning, and development prior to implementation.

- A. *Potential base realignment and closing (BRAC) for Fort Shafter.* The United States Department of Defense is preparing for another BRAC review of military bases in 2005. Conspicuously, Fort Shafter has not been mentioned as a recipient of the recently well publicized massive federal military base spending that is to flow into Hawaii over the next decade. The Legislature could direct the Department of Business, Economic Development and Tourism to initiate discussions with federal authorities regarding any future plans for Fort Shafter and, particularly with commercial and industrial purposes in mind, the "Shafter Flats" area makai of the Moanalua Freeway.
- B. *Designation of a new community development district in urban Honolulu to be overseen by the Hawaii Community Development Authority.* Pursuant to Section 206E-1, Hawaii Revised Statutes, one of the purposes of the Hawaii Community Development Authority is to plan and assist with the redevelopment of "undeveloped, blighted, or economically depressed (areas)...potentially in need of renewal, renovation, or improvement to alleviate such conditions as dilapidation, deterioration, age, and other such factors or conditions which make such areas an economic or social liability."

In answer to the concerns and comments regarding the lack of available new or renovated industrial properties near the urban core, the Legislature could consider directing the Hawaii Community Development Authority; the Department of Business, Economic Development and Tourism, or both to determine whether one or more areas makai of the freeway, between the Aloha Tower complex and the airport would warrant redevelopment under the auspices of the Hawaii

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Community Development Authority. The area could be designated a community development district pursuant to section 206E-5(a) and redeveloped in the same manner that the Kakaako community development district has been and is being redeveloped. Any proposed community development plan for this new district should encourage the redevelopment and expansion of commercial and industrial uses in the district, and steps taken to ensure that improvements to infrastructure do not have the unintended consequence of improved infrastructure raising property values to the point that industrial expansion is impeded.

- C. *State industrial parks.* The Legislature could consider directing the Department of Land and Natural Resources to review the possibility of making more land available for industrial purposes through its industrial parks program pursuant to part VII of Chapter 171, Hawaii Revised Statutes. Further areas that the Legislature could have the Department consider for the development of industrial parks include the present Oahu Community Correctional Center site (if in fact the Legislature foresees relocating the correctional center), the piers and support areas of the former Army terminal (the Kapalama Military Reservation) generally located near the intersection of Nimitz Highway and Waiakamilo Road, and state lands at Sand Island, Kapolei, and Kalaeloa.
- D. *Review the land use and zoning process.* The demand for more commercial and industrial land requires more land to be developed for those uses; that, in turn, requires more speed, flexibility, and certainty in the existing land use and zoning process. A group of representatives of large landowners, environmental interests, urban planners, agricultural interests, land use attorneys, the State Office of Planning, and other state and county planning agencies, should be convened to explore ways to expedite the land use and zoning process.

Presently, to develop land for any urban use in the Ewa or central Oahu agricultural land use district, the land must undergo a State Land Use Commission contested case hearing and action decision to be reclassified from the agricultural district to the urban district. It would probably also need an amendment to the relevant Honolulu development plan for the proper land use designation which, in turn, will require a public hearing and action by the Honolulu Planning Commission and the review and passage of an ordinance by the Honolulu City Council. (The correct land use designation on the development plan should, but need not in all cases, be in place prior to the land use reclassification process.) The application for the development plan amendment would trigger a Chapter 343, Hawaii Revised Statutes, environmental assessment and probably a full environmental impact statement preparation process, which must be completed prior to consideration of the development plan amendment application. The final discretionary step, assuming the land is not in any special district, such as the coastal zone special management area, would be a change in zoning, which again would require a public hearing and action by the Honolulu Planning Commission and the review and passage of an ordinance by the Honolulu City Council. This

all would be followed by what are referred to as ministerial but hardly simple steps, including at minimum, subdivision permits and building permits. These governmental steps are normally preceded by meetings with community groups, neighborhood boards, and a plethora of state and county agencies.

The described process will take a matter of years, not months. It will require a number of experienced consultants, including, at minimum, attorneys, land planners, civil engineers, traffic consultants, environmental consultants and archaeologists. Added to the mix could be environmental or hazard material engineers, acoustical engineers, architects, flora and fauna consultants, economists, and other specialty consultants. The process is very expensive, especially if there are the added costs of land which must be carried during this period.

Further along the process will be added, until then some unknown, conditions of development that will include, at minimum, requirements for improvements to the area's infrastructure, including roads and highways, water distribution and storage system, wastewater collection and treatment system, and electrical utilities. Additional impact fees for basic services, such as police and fire protection, school facilities, and parks, can be anticipated.

Any landowner, even one not bearing land carrying costs, would be very hesitant to undergo this land entitlement process. This is particularly so because the initial steps, while costing money, are discretionary and not guaranteed. The pitfalls of the process have been magnified by recent court decisions overturning earlier obtained land entitlements for failure to follow the exacting steps required by this land entitlement process.

The process and problems involved in making more land available for commercial and industrial use are complex. Simple solutions to problems of this complexity cannot be expected. Simply abolishing the Land Use Commission will not solve these problems. Accordingly, a group of representatives of stakeholders in the land entitlement process should be established to review the entire process with the intent of trying to not only shorten or expedite the process, but also remove some of the uncertainty and risks in the entire land entitlement process. This would benefit not only landowners and developers but, in the final analysis, the end users whether they be homeowners or commercial or industrial businesses.

- E. *Review methods of appraisal for renegotiation of lease rents.* The Legislature could direct the Director of Commerce and Consumer Affairs to convene a group of representatives of commercial and industrial lessors and lessees, financial institutions, and real estate appraisers (through the real estate appraiser program under chapter 466K, Hawaii Revised Statutes) to explore methods of appraisal which may be more fair and equitable to all parties. Presently, according to the responses of both lessors and lessees to the questionnaire, the great majority of

CONCLUDING OBSERVATIONS

renegotiations are based on a set return on the fair market value of the land at its highest and best use without encumbrances, using comparable sale prices of like properties in the area.

A negotiation based on a weighed average of various indices, such as the fair market value of the land, recently renegotiated comparable lease rents, the consumer price index, and a review of the comparable values of the unencumbered land and the lessee improvements, may result in more equitable method of determining lease rents. While this may not relieve the need for more commercial and industrial lands available or address the present needs of some of the lessees with their present leases, it could help future lessees avoid some of the pitfalls being experienced today by some lessees.

ENDNOTES

1. Both parties who returned the completed lessor and lessee questionnaire discussed in this chapter are actively participating in the Task Group discussions.
2. Experts expect pause in Oahu home Sales, Honolulu Star-Bulletin, November 25, 2003.
3. See notes through and accompanying text.

Appendix A

THE SENATE
TWENTY-SECOND LEGISLATURE, 2003
STATE OF HAWAII

S.C.R. NO. 89
S.D. 1

SENATE CONCURRENT RESOLUTION

REQUESTING A STUDY ON REAL PROPERTY LEASES.

1 WHEREAS, during the "Japanese bubble" period covering 1985
2 to 1990, Japanese investments in Hawaii real estate totaled
3 approximately \$15,000,000,000, sending land prices spiraling
4 upward to levels unsustainable by the properties' economic uses;
5 and
6

7 WHEREAS, these artificially high land values were used as
8 the basis for the calculation of highly inflated long-term
9 ground leases, and many of these leases do not permit new lease
10 rents that are less than the previous rent; and
11

12 WHEREAS, having to pay these inflated lease rents has
13 imposed a burden on some lessees who have been forced to
14 undertake cost-cutting measures such as downsizing their
15 businesses, reducing employee work hours and benefits,
16 postponing improvements, and reducing capital investments; and
17

18 WHEREAS, some lessees who were not able to pay their ground
19 rents have had to walk away from their properties and forfeit
20 valuable improvements, and some face mortgage foreclosures or
21 bankruptcy; and
22

23 WHEREAS, the failure of these businesses adversely impacts
24 upon Hawaii's economy, adding to the rolls of the unemployed and
25 reducing tax revenues; and
26

27 WHEREAS, in 1993, the House of Representatives and the
28 Senate adopted H.C.R. No. 312 which created a task force to
29 examine the problems of lessees; and
30

31 WHEREAS, the task force report stated, "Commercial lease
32 rents have increased in recent years. Contracts negotiated some
33 20 to 30 years ago are coming up for renegotiation and some of
34 the lessees have found themselves facing increases in excess of
35 200%. Some are mom and pop operations and neighborhood shops.

1 Increasingly, however, larger businesses, retail chains and
2 other local commercial operations have been forced to shut their
3 doors as their business becomes unviable. Sadly, many jobs are
4 lost, the goods and services they provided in our neighborhoods
5 and communities are lost, their business to supporting
6 industries are lost, the opportunities for our local businesses
7 and entrepreneurs are lost." The task force also found fault
8 with the practice of settling disputes over value by use of
9 arbitration and recommended change; and

10

11 WHEREAS, now that ten years have passed and many problems
12 for lessees still remain; now, therefore,

13

14 BE IT RESOLVED by the Senate of the Twenty-second
15 Legislature of the State of Hawaii, Regular Session of 2003, the
16 House of Representatives concurring, that the Legislative
17 Reference Bureau is requested to study the major problems still
18 facing commercial and other land lessees; and

19

20 BE IT FURTHER RESOLVED that, in conducting the study, the
21 Legislative Reference Bureau is requested to consult with
22 representatives of the Kamehameha Schools, the Hawaii Bankers
23 Association, the Small Landowners of Oahu and Small Landowners
24 Association of Hawaii, the Land Use Research Foundation of
25 Hawaii, the Hawaii Council of Associations of Apartment Owners,
26 and any individual or agency or organization representative with
27 a direct interest in the issues to ensure that all stakeholders
28 are allowed to express their thoughts and concerns; and

29

30 BE IT FURTHER RESOLVED that the Legislative Reference
31 Bureau also is requested to consult with the Attorney General
32 for legal issues, opinions, and advice relating to any
33 constitutional issues related to the study; and

34

35 BE IT FURTHER RESOLVED that the Legislative Reference
36 Bureau is requested to submit a report of its findings and
37 recommendations, including any proposed legislation, to the
38 Legislature no later than twenty days before the convening of
39 the Regular Session of 2004; and

40

41 BE IT FURTHER RESOLVED that a certified copy of this
42 Concurrent Resolution be transmitted to the Director of the
43 Legislative Reference Bureau.

Appendix B

LESSOR QUESTIONNAIRE

1. Total commercial or industrial acreage you lease to third parties?
2. Average vacancy rate over last two years?
3. Total owned acreage zoned commercial or industrial?
4. Is there demand for more commercial/industrial zoned land?
5. Do you have any future plans to develop more acreage for commercial or industrial use? If so, how many acres?
6. Average term of your existing leases?

7. Number and average length of fixed rent (step-up) periods?
8. Average per cent increase per step-up?
9. Number of renegotiated rent periods?
10. Method of determining renegotiated rent?
11. Average per cent increase (or decrease) from last fixed rent and first renegotiated rent?
12. Do your standard leases have a provision that any renegotiated lease rent may not be less than the lease rent for the previous period?
13. Average per cent increase of real property taxes over term of lease?

14. Average per cent increase in assessed value from period:
- | | |
|--------------|--------------|
| 1980 to 1985 | 1990 to 1995 |
| 1985 to 1990 | 1995 to 2000 |
15. For each period in question 14, were any lease rents renegotiated? If so, what was the average per cent increase in lease rent?
16. For the periods above, what were the per cent increases in your general cost of doing business?
17. Do you believe that there is a common problem faced by commercial and industrial lessees resulting from increased lease rentals as a result of renegotiated lease rents?
18. What do you view as a problem, if any, that is prevalent in the commercial leasehold industry?
19. Should the Legislature address this problem with new legislation? If so, what specific legislation is required?

Appendix C

LESSEE QUESTIONNAIRE

1. Type of lease you are subject to: ground lease, improved structure, or sublease?

2. Type of business you engage in?

3. Is permitted use or activity limited under terms of lease?

4. Term of your lease? Commencement and termination of lease?

5. Number and length of fixed (step-up) rent periods in lease?

6. Per cent increase per step-up?

7. Number of renegotiation periods in your lease?

8. Method of determining renegotiated lease rent?

9. Per cent increase (or decrease) from last fixed rent and first renegotiated rent?

10. Calendar year of first renegotiation period?

11. Has second renegotiation period occurred? If so, what was per cent increase in lease rent.

12. Calendar year of second renegotiation period?

13. Does your lease have a provision that any renegotiated lease rent may not be less than the lease rent for the previous period?

14. What is the per cent increase in your lease rent over the term of the lease to date?

15. What proportion of your operating costs of doing business is attributable to lease rent?

16. Over the term of your lease, have the increases in lease rent been proportionate to other costs of doing business, such as costs of wages and benefits for employees, energy costs, shipping costs, and taxes?

17. What do you view as the main problems in your lease?

18. Do you view these problems as prevalent in the leasehold industry?

19. Should the Legislature address these problems with new legislation? If so, what specific legislation is required?

Appendix D

Recipients of Questionnaires

REAL PROPERTY LEASES STUDY

- | | |
|---|----------------------------|
| <input type="checkbox"/> Mr. John Chang, Esq.
Department of the Attorney General | LESSEE & LESSOR |
| <input type="checkbox"/> Ms. Linda O'Day
Kamehameha Schools | LESSEE & LESSOR |
| <input type="checkbox"/> Mr. Dean Uchida
Land Use Research Foundation of Hawaii (LURF) | LESSEE & LESSOR |
| <input type="checkbox"/> Mr. Fred Ferguson-Brey
Bank of Hawaii | LESSEE & LESSOR |
| <input type="checkbox"/> Mr. Lance Tanaka
Bank of Hawaii | LESSEE & LESSOR |
| <input type="checkbox"/> Mr. James W.Y. Wong
Imperial Associates, Ltd. | LESSEE & LESSOR |
| <input type="checkbox"/> Mr. George D. Hao, MAI
George Hao & Associates | LESSOR |
| With copies to: | |
| <input type="checkbox"/> Ms. Phyllis Zerbe
Small Landowners Association of Hawaii | |
| <input type="checkbox"/> Ms. Manya Vogrig | |
| <input type="checkbox"/> Mr. G. Rick Robinson
Kamehameha Schools | LESSOR |
| <input type="checkbox"/> Mr. C. Mike Kido
Estate of James Campbell | LESSOR |
| <input type="checkbox"/> Mr. Timothy Johns
Estate of S. M. Damon | LESSOR |

<input type="checkbox"/> Mr. Warren K. K. Luke Loyalty Enterprises Limited	LESSOR
<input type="checkbox"/> Ms. Cecily Wong Manoa Shopping Center, Inc.	LESSOR
<input type="checkbox"/> Mr. Jeffrey Hall CB Richard Ellis Hawaii	NO QUESTIONNAIRE (see FILE COPY)
<input type="checkbox"/> Mr. Mike Hamasu Colliers Monroe Friedlander Inc	NO QUESTIONNAIRE (see FILE COPY)
<input type="checkbox"/> Mr. Jeff Nasrallah Grubb & Ellis/CBI Incorporated	NO QUESTIONNAIRE (see FILE COPY)
<input type="checkbox"/> Mr Steve Zidek Marriott International, Inc. Pacific Islands	Rec'd Lessee Questionnaire
<input type="checkbox"/> Ms. Jane Sugimura Hawaii Council of Associations of Apartment Owners	LESSEE
<input type="checkbox"/> Mr. William Reese Liggett	LESSEE
<input type="checkbox"/> Mr. Richard Krystoff	LESSEE
<input type="checkbox"/> Mr. Knud Lindgard	LESSEE
<input type="checkbox"/> Ms. Thelma Gretzinger	LESSEE
<input type="checkbox"/> Ms. Helene Carroll, Director Kalia Inc. Cooperative	LESSEE
<input type="checkbox"/> Mr. Eugene Rooney	LESSEE
<input type="checkbox"/> Mr. W. Lloyd Jones, C.E.O. Martin & MacArthur	LESSEE
<input type="checkbox"/> Mr. Phillip J. Silich, President Bacon Universal Co., Inc.	LESSEE

Manoa Shopping Center
2752 Woodlawn Drive

Waikiki Beachcomber Hotel
2300 Kalakaua Avenue

Holiday Inn
1830 Ala Moana Blvd.

Outrigger Hotels and Resorts
2335 Kalakaua Avenue

Ala Moana Hotel
410 Atkinson Drive

Aston Hotels
2155 Kalakaua Avenue, #500

Best Western The Plaza Hotel
3253 N. Nimitz Hwy.

Castle Resorts and Hotels
500 Ala Moana Blvd, #555

Hawaiiana Hotel
260 Beach Wlk

Queen Kapiolani Hotel
150 Kapahulu Avenue

Marc Resorts
2155 Kalakaua Avenue, 3rd Floor

Kyo-ya Company Limited –
Sheraton Hotels
2255 Kalakaua Avenue

Commercial Shelving Inc
P.O. Box 29480

Car & Body Inc.
2855 Ualena Street

K.S. Corporation
60 N. Beretania Street, Suite 910

Bill Shine, Trustee
700 Bishop Street, #1031

Hawaii Air Cargo
1722 Makaki Street, #301

Nunui & Assoc.
P.O. Box 760

Royal Hawaiian Movers
3017 Ualena Street

Warehousing Co.
700 Bishop Street, #1000

Appendix E

THE SENATE
TWENTIETH LEGISLATURE, 1999
STATE OF HAWAII

S.B. NO. 873
S.D. 1
H.D. 2

A BILL FOR AN ACT

RELATING TO REAL PROPERTY APPRAISALS.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. Leasehold ownership in Hawaii is, has been, and
2 will be for the foreseeable future a common form of ownership of
3 land. Lease agreements generally contain a lease rent
4 renegotiation provision that utilizes real property appraisals to
5 determine a critical component in the renegotiation process, that
6 is, the fair market value of the land. Residential and
7 commercial leases are commonly structured whereby the fee simple
8 owner leases the land to the lessee, who as a sublessor then
9 subleases the land or a portion of the land to a sublessee.

10 The legislature finds that it is in the public interest that
11 the lease rent and sublease rent should be based on the fair
12 market value of the land.

13 Leases commonly prohibit a reduction in rent at
14 renegotiation even though a resale property appraisal determines
15 that the lease rent based on the land's fair market value is less
16 than the current lease rent.

17 The purpose of this Act is to:

18 (1) Provide that lease rent based on fair market value as
19 determined by a real property appraisal, that is less
20 than the rental amount currently being paid, shall

1 prevail over an existing lease contract provision,
2 which bars the lowering of lease rents upon
3 renegotiations; and

4 (2) Provide that differences over appraised value be
5 resolved by an appraisal process set forth in
6 statute and not by arbitration.

7 SECTION 2. Section 519-1, Hawaii Revised Statutes, is
8 amended to read as follows:

9 " ~~[[~~§519-1~~]]~~ **Lease renegotiations; calculation of rent;**
10 **definition.** (a) Whenever any agreement or document for the
11 lease of private lands provides for the renegotiation of the
12 rental amount or other recompense during the term of the lease
13 and such renegotiated rental amount or other recompense is based
14 according to the terms of the lease, in whole or in part upon the
15 fair market value of the land, or the value of the land as
16 determined by its highest and best use, or words of similar
17 import, such value, for the purposes of determining the amount of
18 rental or other recompense, shall be calculated upon the use to
19 which the land is restricted by the lease document~~[.]~~; provided
20 that the lease rent, based on fair market value as determined by
21 a real property appraisal, that is less than the rental amount
22 currently being paid, shall prevail over any existing contract
23 provision, which bars the lowering of lease rent upon
24 renegotiation.

1 (b) Any disagreement over fair market value that cannot be
2 resolved by negotiation shall be settled by the procedure of
3 appraisement set forth in sections 10-13.6(b) and 171-18.5(b) and
4 not by arbitration under chapter 658.

5 [(b)] (c) The term "lease", "lease agreement", or "document"
6 as used in this section, means a conveyance leasing privately-
7 owned land by a fee simple owner as lessor, or by a lessee as
8 sublessor, to any person, for a term exceeding five years, in
9 consideration of a return of rent or other recompense."

10 SECTION 3. Statutory material to be repealed is bracketed.
11 New statutory material is underscored.

12 SECTION 4. This Act shall take effect upon its approval.

REPORT TITLE:

Real Property Appraisals

DESCRIPTION:

Provides that during lease renegotiations for private lands, fair market value, as determined through appraisal, if less than current rent amount, shall prevail over any contract provision that bars the lowering of rent. Provides that disagreements over fair market value shall be settled by appraisement and not arbitration. (SB873 HD2)

Appendix F

EXECUTIVE CHAMBERS

HONOLULU

June 19, 2000

COPY

STATEMENT OF OBJECTIONS TO SENATE BILL NO. 873

STATE OF HAWAII

JUN 20 2000

Honorable Members
Twentieth Legislature
State of Hawaii

LEGISLATIVE REFERENCE BUREAU

Pursuant to Section 16 of Article III of the Constitution of the State of Hawaii, I am returning herewith without my approval, Senate Bill No. 873, entitled "A Bill for an Act Relating to Real Property Appraisals."

The purpose of Senate Bill No. 873 is to amend chapter 519, Hawaii Revised Statutes (HRS), which deals with lease rent renegotiations for both commercial and residential leases, to provide that, at the time of renegotiation, a lease rent based on fair market value, if less than the rent currently being paid, will prevail over any existing contract provision that bars the lowering of lease rent upon renegotiation.

An earlier version (House Draft 1) of Senate Bill No. 873 than that which finally passed contained a provision providing tax benefits to landowners to cover lost or reduced rent caused by the bill. An Attorney General review of that version of the bill was inconclusive as to whether the modification of contracts caused by the bill would be regarded as substantial. The final version of the bill deleted the tax benefits for owners. Also, the earlier version of the bill had required that if lease rent were reduced because of the bill, a sublessor was to pass on the rent reduction to the sublessee. The bill as passed no longer provides for this pass through. Prior to the passage of the final version of this bill, the Attorney General expressed the view that it violated the Contracts Clause in Section 10 of Article I of the United States Constitution.

Given the decision of the Supreme Court of Hawaii in Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 736 P.2d 55 (1987), I do not believe this bill will pass constitutional muster.

In Kualoa Ranch, the court struck down section 516-70, HRS, because it constituted an impermissible impairment of contracts. The provision applied to all residential leases. It required that at the end of the lease, at the lessee's option, the lessor had to purchase the leasehold improvements from the lessee. The statute applied to all residential leases, not just those that were included in development tracts subject to condemnation under the lease-to-fee conversion mechanisms of chapter 516. For those leases that were not included in chapter 516, the only finding by the Legislature to support such an exercise of the police power was the "expressed desire of the legislature to accomplish equity." 69 Haw. at 124, 736 P.2d at 63.

The court said that if this desire of the Legislature could

justify this substantial and material change in the contractual obligations and remedies in all existing leases, it could also be used to justify changing any of the other material terms of existing lease agreements, such as rent, term of lease, etc. Such changes can be made in emergency situations and for limited periods. See Home Building & Loan Association v. Blaisdell, 290 U.S. 398, 54 S.Ct. 231, 78 L.Ed. 413 (1934). Here, there was no emergency and no limitation on the duration of the change.

Id.

For Senate Bill No. 873, the only legislative finding in support of the bill is, "The legislature finds that it is in the public interest that the lease rent and sublease rent should be based on the fair market value of the land." It does not appear that under the decision in Kualoa Ranch, this bill would be upheld with just this simple expression as justification.

It may be asserted that legislative findings made twenty-five years ago when Act 185, Session Laws of Hawaii 1975, was enacted to become section 519-2, HRS (which deals with leases


for residential land), could be used to support Senate Bill No. 873 to the extent that the bill applies to residential leaseholds. There is, however, nothing in Senate Bill No. 873 that adopts, reaffirms, or refers to the findings in Act 185 and those findings are more than two decades old. Moreover, there is nothing in Senate Bill No. 873 or the Act 185 findings that supports the treatment of commercial leases by the bill.

There are other problems with Senate Bill No. 873. It provides that appraisals of fair market value will not be settled by arbitration under chapter 658, HRS, but instead will be settled by the procedures for appraisal in sections 10-13.6(b) and 171-18.5(b), HRS. The appraisal method under both sections is to determine fair market value on a per-acre basis, a procedure that is ill-designed for residential property much of which is in 10,000-square-foot lots or less. I believe a per-acre methodology may result in erroneous and inaccurate valuations.

If Senate Bill No. 873 were to become law, it will amend section 519-1, HRS, to provide, in part, that rental renegotiations will not be determined by arbitration and will conflict with section 519-2(b), HRS, which requires arbitration for residential leases whenever parties are unable to achieve an agreement under a reopening provision. The bill will thus create an inconsistency in chapter 519 with respect to residential leaseholds.

For the foregoing reasons, I am returning Senate Bill No. 873 without my approval.

Respectfully,


BENJAMIN J. CAYETANO
Governor of Hawaii

COPY

P R O C L A M A T I O N

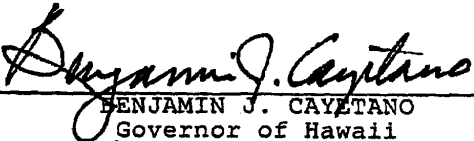
WHEREAS, under Section 16 of Article III of the Constitution of the State of Hawaii, the Governor is required to give notice, by a proclamation, of the Governor's plan to return with the Governor's objections any bill presented to the Governor less than ten days before adjournment sine die or presented to the Governor after adjournment sine die of the Legislature; and

WHEREAS, Senate Bill No. 873, entitled "A Bill for an Act Relating to Real Property Appraisals," passed by the Legislature, was presented to the Governor within the aforementioned period; and

WHEREAS, Senate Bill No. 873 is unacceptable to the Governor of the State of Hawaii;

NOW, THEREFORE, I, BENJAMIN J. CAYETANO, Governor of the State of Hawaii, do hereby issue this proclamation, pursuant to the provisions of Section 16 of Article III of the Constitution of the State of Hawaii, giving notice of my plan to return Senate Bill No. 873 with my objections thereon to the Legislature as provided by said Section 16 of Article III of the Constitution.

DONE at the State Capitol, Honolulu,
State of Hawaii, this 19th
day of June, 2000.


BENJAMIN J. CAYETANO
Governor of Hawaii

Appendix G

BENJAMIN J. CAYETANO
GOVERNOR



EARL I. ANZAI
ATTORNEY GENERAL

THOMAS R. KELLER
FIRST DEPUTY ATTORNEY GENERAL

STATE OF HAWAII
DEPARTMENT OF THE ATTORNEY GENERAL
425 QUEEN STREET
HONOLULU, HAWAII 96813
(808) 586-1500

April 20, 2000

The Honorable Ron Menor
Representative
House of Representatives
State Capitol, Room 320
415 S. Beretania Street
Honolulu, Hawaii 96813

Re: S.B. No. 873, S.D. 1, H.D. 2

Dear Representative Menor:

We are responding to your request for a follow-up memorandum regarding the constitutionality of S.B. No. 873, S.D. 1, H.D. 2 ("S.B. No. 873"), which was further amended by the Committee on Finance of the House of Representatives in pertinent part as follows:

- 1) Deleted requirement that any reduction in a sublessor's rent shall result in a corresponding reduction in rent between the sublessor and the sublessee;
- 2) Deleted the state income and general excise tax credits for lessors to cover loss lease rental income due to the new renegotiation provisions in S.B. No. 873; and
- 3) Added a requirement that disputes arising during rent renegotiation regarding the fair market value of the leased land be resolved by appraisal under section 10-13.6(b), Hawaii Revised Statutes ("HRS") or section 171-18.5 (b), HRS, rather than by arbitration under chapter 658, HRS.

Based on the changes to S.B. No. 873, we are of the opinion that S.B. No. 873 violates Section 10, Article I of the United States Constitution ("Contracts Clause"). Additionally, the proposed amendment to present section 519-1(b), HRS, which adds a new rent dispute resolution mechanism utilizing appraisals as provided in sections 10-13.6(b) and 171-18.5(b), HRS, is in direct conflict with the requirement in present section 519-2(b), HRS, that rent reopening

The Honorable Ron Menor
April 20, 2000
Page 2

disputes be resolved by binding arbitration by the Housing Finance and Development Corporation ("HFDC").

As noted in our legal memorandum of April 6, 2000, the United States Supreme Court has said with regard to Contract Clause claims that "the prohibition is not an absolute one and is *not to be read with literal exactness like a mathematical formula.*" United States Trust Co. v. New Jersey, 431 U.S. 1, 21, 97 S.Ct. 1505, 1517, 52 L.Ed.2d 92, 109 (1977). However, the United States Supreme Court stated in Allied Structural Steel Co. v. Apannaus, 438 U.S. 234, 242, 98 S.Ct. 2716, 2721, 57 L.Ed.2d 727, 734 (1978), that "[i]f the Contracts Clause is to retain any meaning at all, . . . it must be understood to impose some limits upon the power of a State to abridge existing contractual relationships, even in the exercise of its otherwise legitimate police power." [Emphasis in original].

Thus, in analyzing Contracts Clause claims, the United States Supreme Court in United States Trust Co. v. New Jersey, 431 U.S. at 22, 97 S.Ct. at 1517-1518, 52 L.Ed.2d at 109-110, noted as follows:

Yet private contracts are not subject to unlimited modification under the police power. The Court in Blaisdell recognized the laws intended to regulate existing contractual relationships must serve a legitimate purpose. [Citation omitted.] A State could not "adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them." [Citation omitted.] Legislation adjusting the rights and responsibilities of contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption.

The Hawaii Supreme Court in Applications of Herrick & Irish, 82 Haw. 329, 340, 922 P.2d 942, 953 (1996) stated the test to be used in determining whether a statute is constitutional under the Contracts Clause as follows:

In deciding whether a state law has violated the federal constitutional prohibition against impairment of contracts, U.S. Const., art. I, § 10, cl. 1, we must assay the following three criteria: (1) whether the state law operated as a substantial impairment of a contractual relationship; (2) whether the state law was designed to promote a significant and legitimate public purpose; and (3) whether the state law was a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose.

As was discussed in our prior memorandum, it is clear that existing leases could be impaired by the provisions of S.B. No. 873, and that the consequent loss of lease rent income which the lessors may rely upon to pay mortgages, bills, and other expenses could be substantial. Unlike the prior House version of S.B. No. 873, however, the present draft deleted the provision

The Honorable Ron Menor
April 20, 2000
Page 3

for state net income and general excise tax credits to reimburse lessors for any lease rent revenue lost due to a reduction in lease rent that may result from S.B. No. 873. Consequently, the potential harm to lessors and existing contractual rights and expectations under the present bill could indeed be a substantial impairment of their contractual relationships with lessees. Therefore, the only questions remaining are whether the bill "changes the contractual and property rights on reasonable conditions and is of a character appropriate to its public purpose." (Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 120, 736 P.2d 55, 60 (1987).

In this regard, the only public policy noted in S.B. No. 873 is stated as follows:

"The legislature finds that it is in the public interest that the lease rent and sublease rent should be based on the fair market value of the land."

Viewing this public policy against the potentially substantial loss of rental income and the ensuing impairment of existing leases that would occur should S.B. No. 873 be enacted, it would appear that the change in law proposed to be effected by S.B. No. 873 would not be reasonable and would not be "of a character appropriate to its public purpose." Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 120, 736 P.2d 55, 60 (1987).

In this regard, S.B. No. 873 is similar to the statute at issue in Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 736 P.2d 55 (1987), wherein a provision in section 516-70, HRS, which required lessors to purchase a lessee's leasehold improvements at the expiration of the lease term was struck down as unconstitutionally impairing the obligation of existing leases in violation of the Contracts Clause. In Kualoa Ranch, the Supreme Court noted that the public purpose sought to be advanced by section 516-70 was to accomplish equity. In rejecting this justification for the statute in question, the Supreme Court in Kualoa Ranch, 69 Haw. at 124, 736 P.2d at 63, noted as follows:

This statute, as applied to leases already in effect, purely and simply, is an attempt by the legislature to change contractual remedies and obligations, to the detriment of all lessors and to the benefit of all lessees, without relation to the purposes of the leasehold conversion act; without the limitations as to leaseholds subject thereto contained in the conversion provisions; not in the exercise of the eminent domain power, but simply for the purpose of doing equity, as the legislature saw it. If there is any meaning at all to the contract clause, it prohibits the application of HRS § 516-70 to leases existing at the time of the 1975 amendment. Accordingly, that section, as applied to leases existing at the time of the adoption of the 1975 amendment, is declared unconstitutional.

Like the legislative action that was at issue in Kualoa Ranch, the legislature has not cited any broad societal benefits that support the changes proposed by S.B. No. 873. In fact, the public

purpose behind the prior versions of S.B. No. 873 has been lost by the deletion of the requirement that rent reductions that may result under the bill be passed onto the sublessees by sublessors. By deleting this pass-through requirement, S.B. No. 873 now denies the benefits of S.B. No. 873 to those lessees most in need of rent relief.

Consequently, it appears that a court could find that the changes proposed in S.B. No. 873, "as applied to leases already in effect, purely and simply, is an attempt by the legislature to change contractual remedies and obligations to the detriment of all lessors . . ." without advancing any broad societal interest. Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 124, 736 P.2d 55, 63 (1987). S.B. No. 873, as presently worded, does not appear ". . . to promote a significant and legitimate public purpose," and does not appear to be ". . . a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose," thereby failing the final two criteria for determining whether a law is violative of the Contracts Clause. Applications of Herrick & Irish, 82 Haw. 329, 340, 922 P.2d 942, 953 (1996).

Additionally, it should be noted that S.B. No. 873 creates a conflict between the provisions of sections 519-1 and 519-2, HRS, in that S.B. No. 873 now proposes to amend section 519-1 to provide that "[a]ny disagreement over fair market value that cannot be resolved by negotiation shall be settled by the procedure of appraisal set forth in sections 10-13.6(b) and 171-18.5(b) and not by arbitration under chapter 658." Present section 519-2(b) requires binding arbitration by the HFDC "[i]n the event the parties to a lease are unable to achieve an agreement under any reopening provision." This latter provision is in direct conflict with the "appraisal" dispute resolution process provided for in S.B. No. 873.

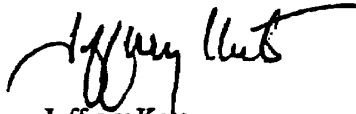
Also, section 10-13.6(b) and section 171-18.5(b), HRS, provide that "[f]air market value shall be determined on a per acre basis . . ." Very few residential lots are one acre in size, with most residential lots being under 10,000 square feet in size. Under normal appraisal practice, the use of one acre lot size to determine fair market value is more appropriate for valuing large parcels and may not result in an appropriate or accurate valuation of smaller lots, which are typically appraised using comparable sales of lots of similar size. Thus, in addition to creating a conflict with the arbitration requirement of section 519-2(b), S.B. No. 873 may also result in erroneous and inaccurate land valuations.

In conclusion, S.B. No. 873 as presently worded, will substantially impair existing leases without furthering any apparent public purpose. The elimination of the net income and general excise tax credits to compensate lessors for any rental income losses that may result from the changes effected by S.B. No. 873, and the deletion of the requirement that any reduction in lease rent be passed on to sublessees by sublessors, make it unlikely that S.B. No. 873 will be found to be a "reasonable and narrowly-drawn means of promoting . . . [a] significant and legitimate public purpose." Applications of Herrick & Irish, 82 Haw. 329, 340, 922 P.2d 942, 953 (1996).

The Honorable Ron Menor
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Consequently, it appears that S.B. No. 873, as presently worded, would be found to violate the Contracts Clause.

Very truly yours,



Jeffery Kao
Deputy Attorney General

Approved:



Earl I. Anzai
Attorney General

JK:jn

cjn:menor.hd2

Appendix H

HOUSE OF REPRESENTATIVES
TWENTY-FIRST LEGISLATURE, 2001
STATE OF HAWAII

H.B. NO. 1131
H.D. 1

A BILL FOR AN ACT

RELATING TO REAL PROPERTY APPRAISALS.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The legislature finds that leasehold ownership
2 in Hawaii is, has been, and probably will continue to be a
3 common form of land ownership. Historically, the land ownership
4 system in Hawaii has been characterized by the concentration of
5 the fee title to lands in the hands of a few estates, trusts,
6 and other private landowners. This pattern of land ownership on
7 Oahu has led to the practice of landowners leasing, rather than
8 selling, their land. The ownership of land beneath developments
9 is consistent with this pattern of land ownership. Owners of
10 property have refused to sell the fee-simple title to lessees
11 and instead established long-term leases. These master leases
12 have terms and conditions weighted in favor of the lessors or
13 fee owners against the lessee developers. The pervasiveness of
14 this practice has resulted in a serious shortage of fee-simple
15 property and increased costs. It has also contributed to a
16 malfunctioning real estate market that has helped to create
17 undesirable socioeconomic impacts in Hawaii.

1 In recent years, there has been a significant appreciation
2 of the apparent and artificial values of real estate on Oahu.
3 Land prices were driven up in the 1980s by wealthy international
4 buyers who were subsequently forced to sell their properties.
5 Nevertheless, the artificially high property values have been
6 used by lessors as a basis to calculate master lease ground
7 rents. Those with long-term commitments have had to pay the
8 higher ground rents and suffer reduced or even negative cash
9 flows. Others, who have not been able to pay the increased
10 ground rents or pass them on to sublessees, have had to move
11 out. Some have had to simply walk away from their properties,
12 forfeiting the valuable improvements they have made to the
13 landowners, and those individuals who were personally
14 responsible for their lease or mortgage obligations, or both,
15 have been faced with mortgage foreclosures and bankruptcy.

16 Practices and policies that result in the use of falsely
17 inflated land values have serious economic consequences, as
18 evidenced by the plight of commercial and condominium lessees in
19 Hawaii who face tremendous increases in renegotiated lease
20 rents, based upon exaggerated land valuations. The resulting
21 uncertainty has a paralyzing effect on transactions regarding
22 these properties.

1 Hawaii businesses and their employees are suffering.
2 Because of unrealistically high rental rates levied by
3 landowners, businesses are forced to take cost cutting measures
4 such as downsizing and part-timing.

5 To accomplish the public purpose of using and managing the
6 property wisely in the community interest requires changing the
7 present practices involved in leasing property. The leasing of
8 property at fair and reasonable prices will alleviate the
9 negative conditions discussed above and promote the economy of
10 Oahu and the public interest, welfare, and security of its
11 citizens. Changing the practice will help to satisfy the
12 pressing public necessity for a secure, strong, and stable
13 economy in Hawaii. Therefore, making the leasing of property
14 viable for the lessees is for a public purpose.

15 It is therefore the purpose of this Act to alleviate the
16 negative results of past economic conditions, by providing for
17 lessees under a long-term master lease of property to lease at
18 fair market value the land on which their developments are
19 sited.

20 Lease agreements generally contain a lease rent
21 renegotiation provision that utilizes real property appraisals
22 to determine a critical component in the renegotiation process

1 -- the fair market value of the land. Residential and
2 commercial leases are commonly structured whereby the fee simple
3 owner leases the land to the lessee, who as a sublessor then
4 subleases the land or a portion of the land to a sublessee.

5 The legislature finds that it is in the public interest
6 that the lease rent and sublease rent should be based on the
7 fair market value of the land.

8 Leases commonly prohibit a reduction in rent at
9 renegotiation even though a resale property appraisal determines
10 that the lease rent based on the land's fair market value is
11 less than the current lease rent.

12 The purpose of this Act is to provide:

13 (1) That lease rent amounts that are:

14 (A) Based on fair market value as determined by a
15 real property appraisal; and

16 (B) Less than the rental amount being paid at the
17 time of renegotiation;

18 shall prevail over amounts specified in an existing
19 lease contract provision that bars the lowering of
20 lease rents upon renegotiations; and

21 (2) That differences over appraised value per square foot
22 be resolved by an appraisal process selected by the

1 lessee which is in conformance with the current
2 Uniform Standards of Professional Appraisal Practice
3 and not by arbitration, which is much more costly and
4 has been used to evade the Uniform Standards of
5 Professional Appraisal Practice.

6 SECTION 2. Section 519-1, Hawaii Revised Statutes, is
7 amended to read as follows:

8 "[f]§519-1[+] **Lease renegotiations; calculation of rent;**

9 **definition.** (a) Whenever any agreement or document for the
10 lease of private lands provides for the renegotiation of the
11 rental amount or other recompense during the term of the lease
12 and [~~such~~] that renegotiated rental amount or other recompense
13 is based, according to the terms of the lease, in whole or in
14 part upon the fair market value of the land, or the value of the
15 land as determined by its highest and best use, or words of
16 similar import, [~~such~~] the value, for the purposes of
17 determining the amount of rental or other recompense, shall be
18 calculated upon the use to which the land is restricted by the
19 lease document[-]; provided that a lease rent:

20 (1) Based on fair market value as determined by a real
21 property appraisal; and

1 (2) That is less than the rental amount currently being
2 paid,
3 shall prevail over any existing contract provision that bars the
4 lowering of lease rent upon renegotiation.

5 (b) At the option of either party, any disagreement over
6 fair market value per square foot that cannot be resolved by
7 negotiation may be settled by an appraisal process selected by
8 the lessee that is in conformance with the Uniform Standards of
9 Professional Appraisal Practice, and shall not be subject to
10 arbitration under chapter 656.

11 [~~b~~] (c) The term "lease", "lease agreement", or
12 "document" as used in this section, means a conveyance leasing
13 privately-owned land by a fee simple owner as lessor, or by a
14 lessee as sublessor, to any person, for a term exceeding five
15 years, in consideration of a return of rent or other
16 recompense."

17 SECTION 3. Statutory material to be repealed is bracketed
18 and stricken. New statutory material is underscored.

19 SECTION 4. This Act shall take effect on January 1, 2050.

Report Title:

Leasehold property, renegotiations

Description:

Requires, in a leasehold renegotiation, that a rent based on fair market value shall apply even if the value is lower than the existing rent and the contract bars the lowering of rent upon renegotiation. (HB1131 HD1)

Appendix I

BENJAMIN J. CAYETANO
GOVERNOR



EARL I. ANZAI
ATTORNEY GENERAL

THOMAS R. KELLER
FIRST DEPUTY ATTORNEY GENERAL

STATE OF HAWAII
DEPARTMENT OF THE ATTORNEY GENERAL
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HONOLULU, HAWAII 96813
(808) 586-1500

March 22, 2001

The Honorable Ron Menor
Senator, Eighteenth District
The Twenty-First Legislature
Hawaii State Capitol, Room 219
415 South Beretania Street
Honolulu, Hawaii 96813

Re: H.B. No. 1131, H.D. 1

Dear Senator Menor:

We are writing in response to your request dated March 22, 2001, for review and comment on whether H.B. No. 1131, H.D. 1 ("H.B. 1131") violates Section 10, Article I, of the United States Constitution ("Contracts Clause"), that provides in pertinent part as follows: "No State shall... pass any... law impairing the obligation of contracts...."

After reviewing H.B. 1131, which we note has apparently been modified to address perceived problems with commercial/ industrial leases, and not to address residential leases, we are of the opinion that H.B. 1131, as applied to commercial/ industrial leases, violates the Contracts Clause.

As we indicated in a prior legal memorandum regarding S.B. No. 873 (the predecessor to H.B. 1131), the United States Supreme Court has said with regard to Contract Clause claims that "the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula." United States Trust Co. v. New Jersey, 431 U.S. 1, 21, 97 S.Ct. 1505, 1517, 52 L.Ed.2d 92, 109 (1977). However, the United States Supreme Court stated in Allied Structural Steel Co. v. Apannaus, 438 U.S. 234, 242, 98 S.Ct. 2716, 2721, 57 L.Ed.2d 727, 734 (1978), that "[i]f the Contracts Clause is to retain any meaning at all, . . . it must be understood to impose some limits upon the power of a State to abridge existing contractual relationships, even in the

The Honorable Ron Menor
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exercise of its otherwise legitimate police power." [Emphasis in original].

Thus, in analyzing Contracts Clause claims, the United States Supreme Court in United States Trust Co. v. New Jersey, 431 U.S. at 22, 97 S.Ct. at 1517-1518, 52 L.Ed.2d at 109-110, stated the following:

Yet private contracts are not subject to unlimited modification under the police power. The Court in Blaisdell recognized the laws intended to regulate existing contractual relationships must serve a legitimate purpose. [Citation omitted.] A State could not "adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them." [Citation omitted.] Legislation adjusting the rights and responsibilities of contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption.

The Hawaii Supreme Court in Applications of Herrick & Irish, 82 Haw. 329, 340, 922 P.2d 942, 953 (1996) stated the test to be used in determining whether a statute is constitutional under the Contracts Clause as follows:

In deciding whether a state law has violated the federal constitutional prohibition against impairment of contracts, U.S. Const., art. I, § 10, cl. 1, we must assay the following three criteria: (1) whether the state law operated as a substantial impairment of a contractual relationship; (2) whether the state law was designed to promote a significant and legitimate public purpose; and (3) whether the state law was a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose.

In determining whether the impairment of contract is substantial, courts may consider "the severity of the impairment [and] the extent to which the subject matter has been regulated in the past." Applications of Herrick & Irish, 82 Haw. 329, 341, 922 P.2d 942, 954 (1996), citing from Schieffelin & Co. V. Department of Liquor Control, 479 A.2d 1191, 1199, 194 Conn. 165, 177-178 (1984). With respect to H.B. 1131, the severity of the impairment of the lease would depend upon the amount of lease rent lost by a lessor. This issue cannot be determined in the absence of actual facts surrounding a lease rent renegotiation.

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Nevertheless, it is clear that existing commercial/ industrial leases could be impaired by the provisions of H.B. 1131, and that the consequent loss of lease rent income which the lessors may rely upon to pay mortgages, bills, distributions to trust beneficiaries, and other expenses could be substantial. Consequently, the potential harm to lessors and existing contractual rights and expectations under the bill could indeed be a substantial impairment of their contractual relationships with lessees. Therefore, the only questions remaining are whether the bill "changes the contractual and property rights on reasonable conditions and is of a character appropriate to its public purpose." (Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 120, 736 P.2d 55, 60 (1987).

The provisions of H.B. 1131 may be found to violate the Contracts Clause unless it can be determined that "the state law was a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose." Applications of Herrick & Irish, 82 Haw. 329, 340, 922 P.2d 942, 953 (1996). See University of Hawaii Profess. Assembly v. Cayetano, 183 P. 3d 1096 (9th cir. 1999) ("whether... the impairment was both reasonable and necessary to fulfill an important public purpose, such that the impairment is justifiable" (citation omitted)); Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 120, 736 P.2d 55, 60 (1978) (whether the statute "changes the contractual and property rights on reasonable conditions and is of a character appropriate to its public purpose.").

In this regard, H.B. 1131 is similar to the statute at issue in Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 736 P.2d 55 (1987), wherein a provision in section 516-70, HRS, which required lessors to purchase a lessee's leasehold improvements at the expiration of the lease term was struck down as unconstitutionally impairing the obligation of existing leases in violation of the Contracts Clause. In Kualoa Ranch, the Supreme Court noted that the public purpose sought to be advanced by section 516-70 was to accomplish equity. In rejecting this justification for the statute in question, the Supreme Court in Kualoa Ranch, 69 Haw. at 124, 736 P.2d at 63, said:

This statute, as applied to leases already in effect, purely and simply, is an attempt by the legislature to change contractual remedies and obligations, to the detriment of all lessors and to the benefit of all lessees, without relation to the purposes of the leasehold conversion act; without the limitations as to leaseholds subject

thereto contained in the conversion provisions; not in the exercise of the eminent domain power; but simply for the purpose of doing equity, as the legislature saw it. If there is any meaning at all to the contract clause, it prohibits the application of HRS § 516-70 to leases existing at the time of the 1975 amendment. Accordingly, that section, as applied to leases existing at the time of the adoption of the 1975 amendment, is declared unconstitutional.

Like the legislative action that was at issue in Kualoa Ranch, there does not appear to be a broad societal benefit present to support the changes proposed by H.B. 1131. The public purpose discussion in H.B. 1131, with regard to commercial/industrial leases does not appear to be sufficiently compelling to withstand constitutional scrutiny. For example, it is not clear that the situation involving commercial/industrial leases is analogous to the plight of lessees of residential land in Hawaii, in which there was an obvious imbalance in bargaining power between lessors and lessees of residential land that resulted from the oligopoly control of land in Hawaii by a few large landowners. Unlike the widespread use of leases with regard to residential land which was a uniquely Hawaiian phenomenon, leases have typically been utilized, both in Hawaii and on the east and west coasts of the mainland, as a means of making land available for commercial/industrial endeavors.

Additionally, it is presently unclear just how pervasive the alleged problem is, or the actual number of commercial/industrial leases with lease rents locked into valuations based on the "Japanese Bubble." This is because a confluence of factors would be required in order for a commercial/industrial lease to be affected by the "Japanese Bubble:"

- a) First, there would have to be a commercial/industrial lease that actually contained provisions that prohibited the reduction of lease rent below previously fixed levels;
- b) Second, the lease rent for the commercial/industrial lease in question would have had to be renegotiated during a fairly limited period during the 1990's, "Japanese Bubble" period in order to be affected; and
- c) Third, the commercial/industrial lease in question would have had to have been of the type of property that was the subject of Japanese investments during the "Japanese Bubble" period.

Furthermore, developers and other businesses seeking ground

The Honorable Ron Menor
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leases for land upon which they will construct substantial improvements, involving significant capital investments, are generally sophisticated individuals and entities that can and do negotiate the terms of the leases they enter into, and have the option of negotiating with several competing lessors to obtain more favorable terms. Therefore, the potential lessee may not have been subject to an imbalance in bargaining leverage that would have forced the potential lessee to accept less than favorable terms.

Finally, even assuming arguendo that some commercial/ industrial leases may in fact contain the restrictive language prohibiting the reduction of lease rent, and have lease rents that may be high based on their renegotiation during the "Japanese Bubble" period, there has been no concrete evidence or incidences cited wherein the lessees have attempted to raise this alleged inequity to the lessors, but the lessors have absolutely, and unreasonably refused to discuss the problem with the lessees or to attempt to negotiate an appropriate and fair adjustment in the lease rent.

Consequently, it appears that a court could find that the changes proposed in H.B. 1131, "as applied to leases already in effect, purely and simply, is an attempt by the legislature to change contractual remedies and obligations to the detriment of all lessors" without advancing any broad societal interest, and are premised on mere supposition and speculation. Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 124, 736 P.2d 55, 63 (1987). H.B. 1131, as presently worded, does not appear ". . . to promote a significant and legitimate public purpose," and does not appear to be ". . . a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose," thereby failing the final two criteria for determining whether a law is violative of the Contracts Clause. Applications of Herrick & Irish, 82 Haw. 329, 340, 922 P.2d 942, 953 (1996).

Also, we continue to note that H.B. 1131 fails to provide for a pass-through of any reduction in lease rent to sublessees. The lack of a pass-through requirement contradicts the statement of public purpose included in the bill, which statement talks about the negative impact of lease rent renegotiation provisions on sublessees. Under the bill, only the holder of the master ground lease, usually the developer, will benefit, thereby

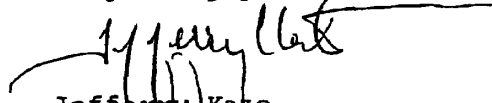
The Honorable Ron Menor
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denying the benefits of the bill to the people most in need of the bill's assistance, namely the sublessees, who are the ultimate tenants and users of the land.


Additionally, H.B. 1131 provides that if the parties are unable to resolve the lease rent dispute by negotiation, then either party can request that the dispute be resolved through an unidentified appraisal process of the lessee's choosing. The failure of the bill to designate a specific process to resolve disputes, and the provision allowing only the lessee to select an appropriate process to resolve the dispute (albeit a process "in conformance with the Uniform Standards of Professional Appraisal Practice"), will almost certainly lead to further disputes, and probable litigation over the appropriateness of the process selected, as well as the manner in which that process was determined.

In conclusion, H.B. 1131, as presently worded, will substantially impair existing leases without furthering any significant public purpose, "...such that the impairment is justifiable." University of Hawaii Profess. Assembly v. Cayetano, 183 F.3d 1096 (9th Cir. 1999). The deletion of the requirement that any reduction in lease rent be passed on to sublessees by sublessors denies the benefits of H.B. 1131 to those smaller lessees who would apparently be most in need of rent relief, and make it unlikely that H.B. 1131 will be found to be a "reasonable and narrowly-drawn means of promoting . . . [a] significant and legitimate public purpose." Applications of Herrick & Irish, 82 Haw. 329, 340, 922 P.2d 942, 953 (1996). Consequently, it appears that H.B. 1131, as presently worded, would be found to violate the Contracts Clause.

Very truly yours,


Jeffrey Kato
Deputy Attorney General

Approved:


Earl I. Anzai
Attorney General

Appendix J

HOUSE OF REPRESENTATIVES
TWENTY-FIRST LEGISLATURE, 2002
STATE OF HAWAII

H.B. NO. 2245
H.D. 1
S.D. 1

A BILL FOR AN ACT

RELATING TO LEASEHOLD.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The tragic and vicious events of September 11,
2 2001, suddenly thrust the United States and Hawaii into an
3 economic whirlpool. The resulting effects of the devastation in
4 New York and Washington, D.C., on our nation's economy were felt
5 immediately thereafter and have escalated in their effects on
6 key aspects of our economy.

7 Businesses large and small in Hawaii are especially
8 vulnerable during this time of crisis. The effects of Hawaii's
9 economic downturn resulting from the Persian Gulf War and
10 Hurricane Iniki are not as substantial in comparison with what
11 happened on September 11th. It is very clear that unless our
12 state government acts quickly and decisively, our economic
13 downward spiral will continue.

14 Many long-term leases have been set at an artificially high
15 "floor" due to the Japanese "Bubble" valuations in the mid
16 1980s. Many of these leases do not allow any new rent to be set
17 lower than the previous rent - the "floor" - and the effect of

1 these now above-market valuations has been devastating to
2 business and residential lessees. These lessees have struggled
3 to get by during the recession Hawaii experienced in the 1990s,
4 and are doing their best to survive in the unexpected economic
5 downturn following the September 11 tragedy. Being required to
6 pay rent based on a highly-inflated and no longer applicable
7 market jeopardizes their continuance.

8 The legislature finds that leasehold ownership in Hawaii
9 is, has been, and probably will continue to be a common form of
10 land ownership. Historically, the land ownership system in
11 Hawaii has been characterized by the concentration of the fee
12 title to lands in the hands of a few estates, trusts, and other
13 private landowners. This pattern of land ownership on Oahu has
14 led to the practice of landowners leasing, rather than selling,
15 their land. The ownership of land beneath developments is
16 consistent with this pattern of land ownership. Owners of
17 property have refused to sell the fee-simple title to lessees
18 and instead established long-term leases. These master leases
19 have terms and conditions weighted in favor of the lessors or
20 fee owners against the lessee developers. The pervasiveness of
21 this practice has resulted in a serious shortage of fee-simple
22 property and increased costs. It has also contributed to a

1 malfunctioning real estate market that has helped to create
2 undesirable socioeconomic impacts in Hawaii.

3 In recent years, there has been a significant appreciation
4 of the apparent and artificial values of real estate on Oahu.
5 Land prices were driven up in the 1980s by wealthy international
6 buyers who were subsequently forced to sell their properties.
7 Nevertheless, the artificially high property values have been
8 used by lessors as a basis to calculate master lease ground
9 rents. Those with long-term commitments have had to pay the
10 higher ground rents and suffer reduced or even negative cash
11 flows. Others, who have not been able to pay the increased
12 ground rents or pass them on to sublessees, have had to move
13 out. Some have had to simply walk away from their properties,
14 forfeiting the valuable improvements they have made to the
15 landowners, and those individuals who were personally
16 responsible for their lease or mortgage obligations, or both,
17 have been faced with mortgage foreclosures and bankruptcy.

18 Practices and policies that result in the use of falsely
19 inflated land values have serious economic consequences, as
20 evidenced by the plight of commercial and condominium lessees in
21 Hawaii who face tremendous increases in renegotiated lease
22 rents, based upon exaggerated land valuations. The resulting

1 uncertainty has a paralyzing effect on transactions regarding
2 these properties.

3 Hawaii businesses and their employees are suffering.
4 Because of unrealistically high rental rates levied by
5 landowners, businesses are forced to take cost-cutting measures
6 such as downsizing and converting full-time employees to part-
7 time.

8 There have been many authoritative reports over the past
9 several years that attest to the magnitude and seriousness of
10 the problem for Hawaii's economy and its people.

11 In 2000, former attorney general Margery Bronster,
12 representing leasehold reform efforts, wrote the governor
13 stating the following:

14 "The imbalance of bargaining power between current lessors
15 and lessees indeed exists with respect to existing leases. The
16 typical current lessee affected by this legislation is a
17 long-term lessee who has made significant investments in the
18 infrastructure and improvements on the land. Whereas, as
19 newcomers can enter the market and take advantage of the
20 'buyer's market', bargain for a fair market rent and avoid the
21 onerous provisions that would require him to pay lease rent
22 based on the market value of a decade ago. The current

1 long-term lessee simply cannot. The current lessee's choice is
2 to pay an inflated or exorbitant rent or vacate and be in breach
3 of the lease. The landlord's damages will be based on the
4 inflated rent that would have been due under the lease. The
5 tenants can neither avoid nor remedy their predicaments.

6 "It is rare for the economic and land conditions to have as
7 great an impact on the local businesses and commercial
8 enterprises as in the State of Hawaii. There is probably no
9 other community in the United States that experienced such a
10 dramatic rise in real estate prices, coupled with a pervasive
11 leasehold land tenure followed by such a sustained and
12 enervating weakened economy. The impact on local business and
13 individual tenants has been devastating. Many examples are
14 available for consideration."

15 Other studies and reports similarly address these problems
16 with respect to residential, condominium, cooperative, and
17 commercial lessees. For example, in 1979, Dr. Laitila of the
18 University of Hawaii observed that "there is a non-competitive
19 market" in Hawaii's industrial real estate and that the
20 valuation process in use then "assumes a competitive real estate
21 market." He predicted dire consequences for lessees whose
22 approaching renegotiation deadline hung over a company's

1 viability "like a short fused time bomb" -- a "little
2 nightmare".

3 In 1987, a report prepared for the housing finance and
4 development corporation stated:

5 "A significant number of condominium and cooperative
6 housing projects are scheduled for their first lease rental
7 negotiations starting in 1990, and the ability to obtain long
8 term fixed rate financing for leasehold condominium purchases
9 will diminish as lease terms progress. Therefore, it is
10 anticipated that motivations of lessees and lessors may change
11 significantly as these negotiations draw closer, and that
12 support for leased fee conversion relief will increase."

13 In a 1991 report entitled "A Summary of the Research . . .
14 Findings from the Office of the Lieutenant Governor" it is
15 stated that regarding condo and cooperative units, "the majority
16 of units are in leasehold projects."

17 In 1994, the business leasehold task force created by
18 H.C.R. No. 312, H.D. 2, S.D. 1, chaired by Representative Calvin
19 Say and made up of lessees, lessors, and concerned citizens,
20 found that the rising cost of lease payments plays a major role
21 in the viability of Hawaii's retail commercial and industrial
22 businesses..

1 The task force report goes on to say: "Commercial lease
2 rents have increased in recent years. Contracts negotiated some
3 twenty or thirty years ago are coming up for renegotiation and
4 some of the lessees have found themselves facing increases in
5 excess of 200 per cent. Some are mom and pop operations and
6 neighborhood shops. Increasingly, however, larger businesses,
7 retail chains and other local commercial operations have been
8 forced to shut their doors as their business becomes nonviable.
9 Sadly, many jobs are lost, the goods and services they provided
10 in our neighborhoods and communities are lost, their businesses
11 and entrepreneurs are lost."

12 The task force also found fault with the practice of
13 settling disputes over value by use of arbitration and
14 recommended change.

15 In 1995, the United States Department of Housing and Urban
16 Development financed a study by the Hawaii real estate research
17 and education center of the University of Hawaii. The report
18 resulting from the study states: "A mounting leasehold crisis
19 exists in Hawaii's leasehold system and is the motivation for
20 this study." The study also cites international monetary
21 policies that resulted in a stronger Japanese yen and major

1 investment in Hawaii causing residential land prices to increase
2 367.8 per cent by the early 1990s.

3 The 1985 to 1990 period has been referred to as the
4 "Japanese Bubble Period" or the "Japanese Bubble Economy Years".
5 The Japanese Ministry of Finance defines the bubble: "In view
6 of its underlying connotations in the contemporary Japanese
7 vernacular, we have opted in this report to use bubble as a term
8 referring to a deviation between actual and theoretical asset
9 prices, but of such magnitude that it has an impact on the
10 livelihoods of many people and interferes with a nations normal
11 economic management." Robert Hastings, an appraiser in Hawaii,
12 describes the impact of the bubble on Hawaii's real estate
13 markets as follows:

14 Between 1985 and 1990, exogenous and artificial forces
15 created the explosive spiral in real estate prices in certain
16 locations in Hawaii that were of interest to foreign investors.
17 These increases were created by forces that result from the
18 interaction of five banking and governmental policies in Japan
19 during a period now characterized as the "Japanese Bubble
20 Economy Years". During the period of years, the Japanese
21 invested \$80,000,000,000 in U.S. commercial and development real
22 estate of which, around \$15,000,000,000 was invested in Hawaii

1 properties. "The impact on Hawaii, with only one half of one
2 per cent of the population of the United States, was much more
3 significant than it was in other U.S. jurisdictions because,
4 during 1988 and 1989, Hawaii received approximately 25 per cent
5 of the total Japanese investment in U.S. real estate... The
6 impact on commercial and residential economics are enormous and
7 the resulting dislocations and economic crises to residents,
8 industry and banks are already occurring."

9 In 1996, the Hawaii Financial Services Associations, a
10 trade association with twenty-five members operating under
11 chapter 412 of the Hawaii Revised Statutes, testified as
12 follows:

13 "The HFSA supports passage of House Concurrent
14 Resolution 130. We believe it's only reasonable and appropriate
15 that all appraisals should be prepared using the Uniform
16 Standards of Professional Appraisal Practice (USPAP). In our
17 view, there is no legitimate reason for deviating from USPAP in
18 evaluating the value of the property.

19 "As financial institutions, we are required by the
20 Financial Institutions Reform, Recovery and Enforcement Act
21 (FIRREA) to use only appraisals which are prepared for us and
22 meet USPAP. Under FIRREA, we cannot use appraisals prepared for

1 our customers even if they meet USPAP requirements. Customers
2 who have obtained and paid for appraisals which do not meet
3 USPAP, have not only wasted their money, but are further
4 confused and upset by the different values between their
5 non-USPAP and USPAP appraisals. Typically, the non-USPAP
6 appraisal has a higher value and the customer cannot understand
7 why the financial institution's appraisal is lower. While it
8 may be a good sales tool for some appraisers to give the
9 customer the highest value, it is really a disservice to them.

10 "Appraisals should not be bargaining devices between
11 parties negotiating new leases or purchase contracts.
12 Appraisals should be based on a common yardstick that is the
13 USPAP. Within these standards, some deviation of valuation may
14 occur, but the differences should be small and the cause for the
15 difference should be clearly identifiable."

16 Legislation introduced in 1996 noted "that small business
17 operations in Hawaii -- operations with 100 employees or less --
18 make up approximately ninety-eight per cent of the estimated
19 30,000 businesses operating in the State today. Small business
20 operations generate two out of every three new jobs in Hawaii
21 and disburse fifty-five per cent of the private workforce
22 payroll and further that the high cost of renegotiating lease

1 rents in Hawaii represents one of the major hurdles to the
2 continued growth of small business operations in the State. The
3 current formula for renegotiating lease rents which is based on
4 'highest and best use' of the property -- threatens to displace
5 those businesses that cannot afford to pay high increases in
6 lease rents."

7 After the "bubble" period created a problem, Anthony Downs,
8 Ph.D., senior fellow at the Brookings Institute, stated as
9 follows:

10 "There are two basic causes of these unexpectedly high
11 values. One is just the shortage of available and desirable
12 land in Hawaii - especially of fee simple land - in comparison
13 with the demand for it. This results in part from the general
14 prosperity of the Hawaiian economy, plus the widespread
15 ownership of land by a few big estates that have leased it to
16 lessees who subsequently built improvements on it.

17 "The second cause is the extraordinary influx of the
18 Japanese investment funds in the period from 1985-1989 that
19 drove land prices to levels unsustainable from economic uses
20 built on the land. Several circumstances affecting Japanese
21 investors were unprecedented and unique. As a result, Japanese
22 investors could and did pay huge prices for land that cannot be

1 supported by any conceivable uses put on that land. I will
2 refer to this period from 1985-1990 as the "Japanese bubble
3 period".

4 The result was a series of land sales, or sales of both
5 land and improvements at extremely high prices. An example is
6 the sale of a downtown office site for \$1,200 per square foot --
7 when no previous site had ever sold for more than \$400 per
8 square foot.

9 Appraisers in Hawaii have used these sales as comparables
10 in lease renegotiations and arbitrations. The result is a
11 setting of land values so high that the rents based on those
12 values surpass the earning power of the improvements on the
13 land. They not only cannot be supported by the existing
14 improvements, but they also cannot be supported by any
15 improvements including the theoretically highest and best uses.

16 Fair rents based upon fair value was the purpose of Senate
17 Bill No. 2633 which was enacted as Act 180, Session Laws of
18 Hawaii 1998, of which the Conference Committee stated: "The
19 purpose of this bill is to protect consumers who lease land by
20 requiring that the fair market value of renegotiated rental
21 amounts for lease be determined in conformance with the Uniform
22 Standards of Professional Appraisal Practice." However, the

1 legislature finds that there is a need for additional
2 clarification, since the legislature finds that not all of the
3 entities that are bound by that Act are currently complying with
4 the requirements of that Act.

5 Finally, the city and county of Honolulu's Ordinance 91-95,
6 which provided a mechanism for converting leasehold interests in
7 condominium units to fee interests through the city's
8 condemnation power, was subsequently upheld by the United States
9 Court of Appeals for the Ninth Circuit in Richardson v. City and
10 County of Honolulu, 124 F.3d 1150 (9th Cir. 1997), cert. denied,
11 119 S.Ct. 168 (1998). In particular, the Court of Appeals noted
12 that in enacting that ordinance, the city found that landowners
13 had refused to sell proportionate shares in their fee simple
14 titles and that the few sales that occurred involved exorbitant
15 prices, and that this refusal to sell fee simple titles, along
16 with other factors, had caused a dramatic increase in the price
17 of housing in Honolulu.

18 The Ninth Circuit further noted the city's finding that
19 persons wishing to reside on Oahu were forced to sign long-term
20 leases that provide for periodic rent renegotiation. These
21 conditions led to "the acute recent inflation of land costs
22 (that) has adversely affected lease rent negotiations of persons

1 who have purchased leasehold multi-family units as their homes:
2 in some instances renegotiations have resulted in lease rents
3 that have increased over 1,000 percent. Under the burden of
4 increased lease rents, many owner-occupants of residential
5 condominium apartments..., especially those on fixed incomes,
6 have found, and will continue to find themselves unable to
7 afford to continue living in their homes."

8 Finally, the court noted the city's findings that these
9 defects in the housing market would adversely affect the city's
10 economy:

11 "There is a close relationship between the monetary values
12 accorded land on Oahu and the stability and strength of Oahu's
13 economy as a whole. Residential condominium ... land values,
14 artificially inflated by concentrated or single ownership,
15 market conditions or other factors, skew Oahu's economy toward
16 unnecessarily high levels. The pervasive and substantial
17 contribution made to inflation by high residential condominium
18 ... land values creates a potential for economic instability and
19 disruption on Oahu. Economic inflation, instability and
20 disruptions on Oahu have real and potential damaging
21 consequences for all members of an affected society."

1 The legislature similarly finds that there is a need to
2 reduce the potential for economic instability, not only on Oahu,
3 but with respect to the entire State. To accomplish the public
4 purpose of using and managing the property wisely in the
5 community interest requires changing the present practices
6 involved in leasing property. The leasing of property at fair
7 and reasonable prices will alleviate the negative conditions
8 discussed in this section while promoting the economy of the
9 State and the public interest, welfare, and security of its
10 citizens. Changing the practice will help to satisfy the
11 pressing public necessity for a secure, strong, and stable
12 economy in Hawaii. Therefore, the legislature finds that making
13 the leasing of property viable for lessees is a valid public
14 purpose.

15 The legislature therefore finds that there is a need to
16 alleviate the negative results of past economic conditions by
17 allowing lessees under a long-term master lease of property to
18 lease at fair market value the land on which their developments
19 are sited. Lease agreements generally contain a lease rent
20 renegotiation provision that utilizes real property appraisals
21 to determine a critical component in the renegotiation process,
22 namely, the fair market value of the land. Residential and

1 commercial leases are commonly structured whereby the fee simple
2 owner leases the land to the lessee, who as a sublessor then
3 subleases the land or a portion of the land to a sublessee.
4 Leases commonly prohibit a reduction in rent at renegotiation
5 even though a resale property appraisal determines that the
6 lease rent based on the land's fair market value is less than
7 the current lease rent. The legislature finds that it is in the
8 public interest that the lease rent and sublease rent should be
9 based on the fair market value of the land.

10 Accordingly, the purpose of this Act is to require, in
11 leasehold renegotiations, that a rent based on fair market value
12 shall apply even if the value is lower than the existing rent
13 and the contract bars the lowering of rent upon renegotiation.
14 In particular, lease rent amounts that are:

- 15 (1) Based on fair market value as determined by a real
16 property appraisal; and
- 17 (2) Less than the rental amount being paid at the time of
18 renegotiation;

19 shall prevail over amounts specified in an existing lease
20 contract provision that bars the lowering of lease rents upon
21 renegotiations. Differences over appraised value per square
22 foot shall be resolved by an appraisal process selected by the

1 lessee which is in conformance with the current Uniform
2 Standards of Professional Appraisal Practice and not by
3 arbitration, which the legislature finds is much more costly and
4 has been used to evade the uniform standards.

5 SECTION 2. The Hawaii Revised Statutes is amended by
6 adding a new chapter to be appropriately designated and to read
7 as follows:

8 "CHAPTER

9 REAL PROPERTY LEASES

10 § -1 Definitions. As used in this chapter, unless the
11 context clearly requires otherwise:

12 "Fee owner" means the person who owns the fee simple title
13 to the real property leased under a property development and the
14 person's heirs, successors, legal representatives, and assigns.

15 "Lease" means the conveyance of land or an interest in land
16 by a fee simple owner, or other lessor, to a lessee who owns the
17 project situated on the land for an original, or extended lease
18 term of thirty years or more in consideration of payment of rent
19 or other recompense.

20 "Leased fee" and "leased fee interest" means reversionary
21 interests of the fee owner, lessor, and all legal and equitable

1 owners of land that are leased, other than the lessee's or a
2 sublessee's interest.

3 "Legal and equitable owners" means the fee simple owners
4 and all persons having legal or equitable ownership interests in
5 the leased fee or in the lessor's leasehold estate, including
6 mortgagees, developers, lienors, and sublessors, and their
7 respective heirs, successors, legal representatives, and
8 assigns.

9 "Lessee" means any person who owns a project and to whom
10 land upon which the project is located is leased, including the
11 person's heirs, successors, legal representatives, and assigns.

12 "Lessor" means any person who leases or subleases land to
13 another, and the person's heirs, successors, legal
14 representatives, and assigns.

15 "Lessors", "lessees", "fee owners", and "legal and
16 equitable owners" include individuals, both masculine and
17 feminine; corporations, firms, associations, partnerships,
18 limited liability companies, trusts, and estates; and the State
19 of Hawaii and any county or other political subdivision of the
20 State. When more persons than one are the lessors, lessees, fee
21 owners, or legal and equitable owners of a lot, the terms apply
22 to each of them, jointly and severally.

1 "Master lease" means the dominant lease in a property
2 development issued or assigned by the fee owner, or the lessor,
3 to the owner of a project, all or portions of which may be
4 subleased to occupants.

5 "Uniform standards" means the current Uniform Standards of
6 Professional Appraisal Practice approved by the director of
7 commerce and consumer affairs pursuant to section 466K-4(a).

8 **§ -2 Lease renegotiations; calculation of rent;**
9 **definition.** Whenever any agreement or document for the lease of
10 private lands provides for the renegotiation of the rental
11 amount or other recompense during the term of the lease, and the
12 renegotiated rental amount or other recompense is based,
13 according to the terms of the lease, in whole or in part upon
14 the fair market value of the land, or the value of the land as
15 determined by its highest and best use, or words of similar
16 import, such value, for the purposes of determining the amount
17 of rental or other recompense, shall be calculated upon the use
18 to which the land is restricted by the lease document; provided
19 that:

- 20 (1) Fair market value per square foot shall be determined
21 in conformance with the uniform standards;

- 1 (2) Any disputes over value shall be settled by the
2 procedure selected by the lessee and not by
3 arbitration under chapter 658; and
- 4 (3) Any other provision or remedy afforded any class of
5 lessee in this chapter or in any other law relating to
6 the lease of real property shall be equally available
7 to all lessees; and no provision, right, benefit, or
8 remedy afforded to any class of lessee or tenant by
9 this chapter or in any other law or rule shall be
10 denied to any other class, lessee, or tenant.

11 **§ -3 Rules.** The housing and community development
12 corporation of Hawaii shall adopt rules pursuant to chapter 91
13 as may be necessary to implement this chapter.

14 **§ -4 Applicability.** This chapter applies to all
15 property developments that are occupied by lessees pursuant to
16 master leases whether executed before or after the effective
17 date of this chapter.

18 **§ -5 Priority.** If this chapter conflicts with another
19 state law, this chapter shall prevail."

20 SECTION 3. Section 519-1, Hawaii Revised Statutes, is
21 amended to read as follows:

1 " ~~{}~~§519-1~~{}~~ Lease renegotiations; calculation of rent;
2 **definition.** (a) Whenever any agreement or document for the
3 lease of private lands provides for the renegotiation of the
4 rental amount or other recompense during the term of the lease
5 and ~~such~~ that renegotiated rental amount or other recompense
6 is based, according to the terms of the lease, in whole or in
7 part upon the fair market value of the land, or the value of the
8 land as determined by its highest and best use, or words of
9 similar import, ~~such~~ the value, for the purposes of
10 determining the amount of rental or other recompense, shall be
11 calculated upon the use to which the land is restricted by the
12 lease document~~-~~; provided that any lease in existence on the
13 effective date of this Act that has been renegotiated after
14 January 1, 1990, shall be allowed a one-time adjustment upon
15 application of the lessee to reflect fair market rental value as
16 determined by a real property appraisal in conformance with the
17 Uniform Standards of Professional Appraisal Practice. This
18 adjustment shall be a one-time correction to the lease and shall
19 prevail over any existing contract provision to the contrary.
20 The new adjusted rent shall be prospective and shall become
21 effective upon the determination of the fair market rental value
22 as determined by the appraisal. To the extent that the lease

1 rent amount is reduced pursuant to this subsection, a sublessor
2 shall adjust any sublease to a sublessee for the premises or
3 portion thereof covered by the sublease to the extent necessary
4 to achieve fair market rent.

5 (b) At the option of either party, any disagreement over
6 fair market value per square foot that cannot be resolved by
7 negotiation may be settled by an appraisal process that is in
8 conformance with the Uniform Standards of Professional Appraisal
9 Practice, and shall not be subject to arbitration under chapter
10 658.

11 If a party does not agree with the value produced, that
12 party may appoint and pay for the services of an appraiser of
13 its choice, who shall perform an appraisal. If the two
14 appraisers cannot resolve the differing valuations, by mutual
15 agreement or, failing agreement, by the senior judge of the
16 circuit court of the circuit in which the real property is
17 located, a third appraiser shall be appointed to review the work
18 done and the issue shall be settled by a decision of two of the
19 three appraisers. The two appraisers shall provide in writing
20 their findings, conclusions, methodology, and reasoning clearly
21 showing how they arrived at their decision. The cost of the

1 third appraiser shall be divided and paid equally by the lessee
2 and lessor.

3 ~~[(b) The term "lease",]~~ (c) As used in this section:

4 "Lease", "lease agreement", or "document" [as used in this
5 section,] means a conveyance leasing privately-owned land by a
6 fee simple owner as lessor, or by a lessee as sublessor, to any
7 person, for a term exceeding five years, in consideration of a
8 return of rent or other recompense.

9 "Uniform Standards of Professional Appraisal Practice"
10 means the current Uniform Standards of Professional Appraisal
11 Practice approved by the director of commerce and consumer
12 affairs pursuant to section 466K-4(a)."

13 SECTION 4. If any provision of this Act, or the
14 application thereof to any person or circumstance is held
15 invalid, the invalidity does not affect other provisions or
16 applications of the Act, which can be given effect without the
17 invalid provision or application, and to this end the provisions
18 of this Act are severable.

19 SECTION 5. Statutory material to be repealed is bracketed
20 and stricken. New statutory material is underscored.

21 SECTION 6. This Act shall take effect on July 1, 2020.

Report Title:

Real Property Leases; Renegotiation

Description:

Requires, in leasehold renegotiations, that a rent based on fair market value shall apply even if that value is lower than existing rent and the lease contract bars the lowering of rent upon renegotiation. Allows a one-time rent adjustment to reflect fair market value for any existing lease renegotiated after 1/1/90. (SD1)

Appendix K



ATTORNEY GENERAL
THOMAS R. KELLER
FIRST DEPUTY ATTORNEY GENERAL

STATE OF HAWAII
DEPARTMENT OF THE ATTORNEY GENERAL
PUBLIC SAFETY, HAWAIIAN HOME LANDS AND HOUSING DIVISION
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COPY

April 11, 2002

The Honorable Ron Menor
Chairperson, Senate Committee on Commerce,
Consumer Protection and Housing
Twenty-first State Legislature
State Capitol, Room 219
Honolulu, Hawaii 96813

Dear Senator Menor:

Re: House Bill No. 2245, H.D. 1, S.D. 1

Pursuant to the request stated in House Standing Committee Report No. 3301, we have reviewed the above bill and offer our opinion as to its legality and constitutionality.

Briefly, the bill provides that:

1. Notwithstanding lease provisions, lessee may request a one-time lowering of lease rent based on fair market value;
2. USPAP be used to calculate fair market value in lease renegotiation; and
3. Disputes in renegotiation be settled not by arbitration but by a method chosen by the lessee only.

We believe that the bill results in an unconstitutional impairment of contractual obligations and relationships. Like two other bills that passed the legislature in previous sessions (Senate Bill No. 873 in 2000 and House Bill No. 1131 in 2001) and were vetoed by the governor because of constitutional concerns, this bill also fails to meet the test set forth by the Hawaii Supreme Court in Application of Herrick & Irish, 82 Haw. 329, 340, 922 P.2d 942, 954 (1996).

The contracts clause of the United States Constitution prohibits the impairment of the obligation of contracts. U.S. Const. art. I, § 10. However, the United States Supreme Court said: "the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula." United States Trust Co. v. New Jersey, 431 U.S. 1, 21, 97 S.Ct. 1505, 1517, 52 L.Ed.2d 92, 109 (1977). On the other hand, the Court also stated: "If the Contracts Clause is to retain any meaning at all . . . it must be understood to impose some limits

The Honorable Ron Men
Chairperson, Senate Committee on Commerce,
Consumer Protection and Housing
April 11, 2002
Page 2

upon the power of a State to abridge existing contractual relationships, even in the exercise of its otherwise legitimate police power." [Emphasis in original]. The Court further stated in United States Trust that the State could not repudiate debts or destroy contractual rights or deny the means to enforce them. United States Trust, 431 U.S. at 22. "Legislation adjusting the rights and responsibilities of the contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption." Id.

The Hawaii Supreme Court has also spoken on the matter. It set forth the test to be applied in determining whether a statute is constitutional under the Contracts Clause. Application of Herrick & Irish, 82 Haw. 329, 340, 922 P.2d 942, 954 (1996).

In deciding whether a state law has violated the federal constitutional prohibition against impairment of contracts, [citation omitted], we must assay the following three criteria: (1) whether the state law operated as a substantial impairment of a contractual relationship; (2) whether the state law was designed to promote a significant and legitimate public purpose; and (3) whether the state law was a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose.

Id. The Court further stated that courts may consider "the severity of the impairment [and] the extent to which the subject matter has been regulated in the past." Id.

It is clear that this bill changes contractual obligations. Lessors will be affected by the loss of revenue that they depended upon to pay their mortgages, bills, distributions to trust beneficiaries, and other expenses. The severity of the loss will depend on the procedure used and the amount of lost revenue. Accordingly, the potential harm to the lessors under the provisions of this bill could indeed be a substantial impairment of their contractual obligations and relationships with the lessees.

That being the case, the next step is to determine whether the law is designed to promote a significant and legitimate public purpose. The Hawaii Supreme Court clarified this by requiring that the public purpose serve to further a broad societal interest and not to accomplish equity by providing a remedy for a certain few. Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 123, 736 P.2d 55 (1987). In Anthony, the law required lessors to purchase the leasehold improvements upon termination of the lease regardless of any provision of the lease to the contrary. The Court noted that the purpose of the law was to provide equity. The Court held that this stated purpose did not meet the test of broad societal interest and found that the law was unconstitutional. Anthony, 69 Haw. at 124. In section 1, the bill states that the legislature intends to promote economic stability. The bill may impose an economic loss to the lessors and an economic gain to the lessees. But it is not clear why this one-time re-opening of existing contracts would promote economic stability. In spite of the findings in section 1, we cannot

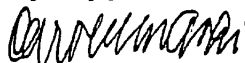
The Honorable Ron Mer
Chairperson, Senate Committee on Commerce,
Consumer Protection and Housing
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conclude that the bill meets its stated purpose of economic stability or furthers a broad societal interest. To the extent the bill merely seeks to accomplish equity, Anthony indicates that the provision of equity for some lessees does not meet the test of broad societal interest. And as such, the bill does not meet constitutional muster.

Even assuming arguendo that the bill is designed to promote a significant and legitimate public purpose, the bill does not appear to provide a reasonably and narrowly-drawn means to accomplish the significant and legitimate public purpose. Even though the legislature limited its inquiry to the problem created by the Japanese bubble economy, it did not limit the application of the bill to those leases directly affected by this phenomena. Also, although the problem of the oligopoly and residential leases in Hawaii is unique and found nowhere else in the United States, this problem does not apply to commercial leases. Most businesses lease their property rather than purchase them in fee simple. Furthermore, the businesses that construct major improvements involving significant capital investments are generally run by managers with the knowledge and skill to negotiate terms of leases that are favorable. Those businesses with less investment in their property are more likely to be able to relocate. Furthermore, agreeing to a fixed rent even though land values may fluctuate over the fixed rent period is a business risk that businesses in seeking a profit should take into consideration in negotiating a lease in the first place. In addition, the lessees have options available to them. They may continue to lease at the higher than market value rent, sell their leasehold and move elsewhere, negotiate a more favorable lease with another lessor because the fair market value of land at this time is lower, or in the case of the residential lessee, he may seek condemnation of the leased fee. Lastly, if this is an emergency measure, there must be a "limitation on the duration of the change," and there appears to be none. Anthony, 69 Haw. at 124.

Hence, in applying the test of Application of Herrick & Irish, we believe that House Bill No. 2245, H.D. 1, S.D. 1 violates the Contracts Clause of the United States Constitutions in that it substantially impairs contractual relationships without promoting a significant and legitimate broad societal interest.

Very truly yours,



Carolee M. Aoki
Deputy Attorney General

APPROVED:



Pa
Earl I. Anzai
Attorney General

Appendix L

PERMANENT FILE

THE SENATE
TWENTY-SECOND LEGISLATURE, 2003
STATE OF HAWAII

JAN 21 2003

S.B. NO. 905

A BILL FOR AN ACT

RELATING TO LEASEHOLD.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The tragic and vicious events of September 11,
2 2001, suddenly thrust the United States and Hawaii into an
3 economic whirlpool. The resulting effects of the devastation in
4 New York and Washington, D.C., on our nation's economy were felt
5 immediately thereafter and have escalated in their effects on
6 key aspects of our economy.

7 Businesses large and small in Hawaii are especially
8 vulnerable during this time of crisis. The effects of Hawaii's
9 economic downturn resulting from the Persian Gulf War and
10 Hurricane Iniki are not as substantial in comparison with what
11 happened on September 11th. It is very clear that unless our
12 state government acts quickly and decisively, our economic
13 downward spiral will continue.

14 Many long-term ground leases have been set at an
15 artificially high "floor" due to the Japanese "Bubble"
16 valuations in the mid 1980s. Many of these leases do not allow
17 any new rent to be set lower than the previous rent - the

1 "floor" - and the effect of these now above-market valuations
2 has been devastating to business and residential lessees. These
3 lessees have struggled to get by during the recession Hawaii
4 experienced in the 1990s, and are doing their best to survive in
5 the unexpected economic downturn following the September 11
6 tragedy. Being required to pay rent based on a highly-inflated
7 and no longer applicable market jeopardizes their continuance.

8 The legislature finds that leasehold ownership in Hawaii
9 is, has been, and probably will continue to be a common form of
10 land ownership. Historically, the land ownership system in
11 Hawaii has been characterized by the concentration of the fee
12 title to lands in the hands of a few estates, trusts, and other
13 private landowners. This pattern of land ownership on Oahu has
14 led to the practice of landowners leasing, rather than selling,
15 their land. The ownership of land beneath developments is
16 consistent with this pattern of land ownership. Owners of
17 property have refused to sell the fee-simple title to lessees
18 and instead established long-term leases. These long-term
19 ground leases have terms and conditions weighted in favor of the
20 lessors or fee owners against the lessee developers. The
21 pervasiveness of this practice has resulted in a serious
22 shortage of fee-simple property and increased costs. It has

1 also contributed to a malfunctioning real estate market that has
2 helped to create undesirable socioeconomic impacts in Hawaii and
3 has resulted in windfall profits to lessors due to the fact that
4 they have been able to collect above-market rentals under those
5 leases from and after 1985 due to a totally unforeseen
6 phenomenon known as the "Japanese Bubble" period.

7 From 1985 through the early 1990s, there was a significant
8 appreciation of the apparent and artificial values of real
9 estate on Oahu. Land prices were driven up in the 1980s by
10 wealthy international buyers who were subsequently forced to
11 sell their properties. Nevertheless, the artificially high
12 property values have been used by lessors as a basis to
13 calculate long-term lease ground rents. Those with long-term
14 commitments have had to pay the unsupportable and artificially
15 higher ground rents and suffered reduced or even negative cash
16 flows. Others, who have not been able to pay the increased
17 ground rents or pass them on to sublessees, have had to move
18 out. Some have had to simply walk away from their properties,
19 forfeiting the valuable improvements they have made to the
20 landowners, and those individuals who were personally
21 responsible for their lease or mortgage obligations, or both,
22 have been faced with mortgage foreclosures and bankruptcy.

1 Practices and policies that result in the use of
2 artificially inflated land values have serious economic
3 consequences, as evidenced by the plight of commercial and
4 condominium lessees in Hawaii who face tremendous increases in
5 renegotiated lease rents, based upon exaggerated land
6 valuations. The resulting uncertainty has a paralyzing effect
7 on transactions regarding these properties.

8 Hawaii businesses and their employees are suffering.
9 Because of unrealistically high rental rates levied by
10 landowners, businesses have been forced to take cost-cutting
11 measures such as downsizing, converting full-time employees to
12 part-time, reducing employee benefits, putting off tenant
13 improvements, reducing capital investment in their businesses
14 and other measure debilitating to businesses.

15 There have been many authoritative reports over the past
16 several years that attest to the magnitude and seriousness of
17 the problem for Hawaii's economy and its people.

18 In 2000, former attorney general Margery Bronster,
19 representing leasehold reform efforts, wrote the governor
20 stating the following:

21 "The imbalance of bargaining power between current lessors
22 and lessees indeed exists with respect to existing leases. The

1 typical current lessee affected by this legislation is a long-
2 term lessee who has made significant investments in the
3 infrastructure and improvements on the land. Whereas, as
4 newcomers can enter the market and take advantage of the
5 'buyer's market', bargain for a fair market rent and avoid the
6 onerous provisions that would require him to pay lease rent
7 based on the market value of a decade ago. The current long-
8 term lessee simply cannot. The current lessee's choice is to
9 pay an artificially inflated or exorbitant rent or to not pay
10 the rent and vacate the premises, which would place the lessee
11 in breach of the lease. The lessor's damages will be based on
12 the inflated rent that would have been payable under the lease.
13 The lessees can neither avoid nor remedy their predicaments.

14 "It is rare for the economic and land conditions to have as
15 great an impact on the local businesses and commercial
16 enterprises as in the State of Hawaii. There is probably no
17 other community in the United States that experienced such a
18 dramatic rise in real estate prices, coupled with a pervasive
19 leasehold land tenure followed by such a sustained and
20 enervating weakened economy. The impact on local business and
21 individual lessees has been devastating. Many examples are
22 available for consideration."

1 Other studies and reports similarly address these problems
2 with respect to residential, condominium, cooperative, and
3 commercial lessees. For example, in 1979, Dr. Laitila of the
4 University of Hawaii observed that "there is a non-competitive
5 market" in Hawaii's industrial real estate and that the
6 valuation process in use then "assumes a competitive real estate
7 market." He predicted dire consequences for lessees whose
8 approaching renegotiation deadline hung over a company's
9 viability "like a short fused time bomb" -- a "little
10 nightmare".

11 In 1987, a report prepared for the housing finance and
12 development corporation stated:

13 "A significant number of condominium and cooperative
14 housing projects are scheduled for their first lease rental
15 negotiations starting in 1990, and the ability to obtain long
16 term fixed rate financing for leasehold condominium purchases
17 will diminish as lease terms progress. Therefore, it is
18 anticipated that motivations of lessees and lessors may change
19 significantly as these negotiations draw closer, and that
20 support for leased fee conversion relief will increase."

21 In a 1991 report entitled "A Summary of the Research
22 Findings from the Office of the Lieutenant Governor" it is

1 stated that regarding condominium and cooperative units, "the
2 majority of units are in leasehold projects."

3 In 1994, the business leasehold task force created by
4 H.C.R. No. 312, H.D. 2, S.D. 1, chaired by Representative Calvin
5 Say and made up of lessees, lessors, and concerned citizens,
6 found that the rising cost of lease payments plays a major role
7 in the viability of Hawaii's retail commercial and industrial
8 businesses.

9 The task force report goes on to say: "Commercial lease
10 rents have increased in recent years. Contracts negotiated some
11 twenty or thirty years ago are coming up for renegotiation and
12 some of the lessees have found themselves facing increases in
13 excess of 200 per cent. Some are mom and pop operations and
14 neighborhood shops. Increasingly, however, larger businesses,
15 retail chains and other local commercial operations have been
16 forced to shut their doors as their business becomes nonviable.
17 Sadly, many jobs are lost, the goods and services they provided
18 in our neighborhoods and communities are lost, their businesses
19 and entrepreneurs are lost."

20 The task force also found fault with the practice of
21 settling disputes over value by use of arbitration and
22 recommended change.

1 In 1995, the United States Department of Housing and Urban
2 Development financed a study by the Hawaii real estate research
3 and education center of the University of Hawaii. The report
4 resulting from the study states: "A mounting leasehold crisis
5 exists in Hawaii's leasehold system and is the motivation for
6 this study." The study also cites international monetary
7 policies that resulted in a stronger Japanese yen and major
8 investment in Hawaii causing residential land prices to increase
9 367.8 per cent by the early 1990s.

10 The 1985 to 1990 period has been referred to as the
11 "Japanese Bubble Period" or the "Japanese Bubble Economy Years".
12 The Japanese Ministry of Finance defines the bubble: "In view
13 of its underlying connotations in the contemporary Japanese
14 vernacular, we have opted in this report to use bubble as a term
15 referring to a deviation between actual and theoretical asset
16 prices, but of such magnitude that it has an impact on the
17 livelihoods of many people and interferes with a nations normal
18 economic management." Robert Hastings, an appraiser in Hawaii,
19 describes the impact of the bubble on Hawaii's real estate
20 markets as follows:

21 Between 1985 and 1990, exogenous and artificial forces
22 created the explosive spiral in real estate prices in certain

1 locations in Hawaii that were of interest to foreign investors.
2 These increases were created by forces that result from the
3 interaction of five banking and governmental policies in Japan
4 during a period now characterized as the "Japanese Bubble
5 Economy Years". During the period of years, the Japanese
6 invested \$80,000,000,000 in U.S. commercial and development real
7 estate of which, around \$15,000,000,000 was invested in Hawaii
8 properties. "The impact on Hawaii, with only one half of one
9 per cent of the population of the United States, was much more
10 significant than it was in other U.S. jurisdictions because,
11 during 1988 and 1989, Hawaii received approximately 25 per cent
12 of the total Japanese investment in U.S. real estate... The
13 impact on commercial and residential economics are enormous and
14 the resulting dislocations and economic crises to residents,
15 industry and banks are already occurring."

16 In 1996, the Hawaii Financial Services Associations, a
17 trade association with twenty-five members operating under
18 chapter 412 of the Hawaii Revised Statutes, testified as
19 follows:

20 "The HFSA supports passage of House Concurrent Resolution
21 130. We believe it's (sic) only reasonable and appropriate that
22 all appraisals should be prepared using the Uniform Standards of

1 Professional Appraisal Practice (USPAP). In our view, there is
2 no legitimate reason for deviating from USPAP in evaluating the
3 value of the property.

4 "As financial institutions, we are required by the
5 Financial Institutions Reform, Recovery and Enforcement Act
6 (FIRREA) to use only appraisals which are prepared for us and
7 meet USPAP. Under FIRREA, we cannot use appraisals prepared for
8 our customers even if they meet USPAP requirements. Customers
9 who have obtained and paid for appraisals which do not meet
10 USPAP, have not only wasted their money, but are further
11 confused and upset by the different values between their non-
12 USPAP and USPAP appraisals. Typically, the non-USPAP appraisal
13 has a higher value and the customer cannot understand why the
14 financial institution's appraisal is lower. While it may be a
15 good sales tool for some appraisers to give the customer the
16 highest value, it is really a disservice to them.

17 "Appraisals should not be bargaining devices between
18 parties negotiating new leases or purchase contracts.
19 Appraisals should be based on a common yardstick that is the
20 USPAP. Within these standards, some deviation of valuation may
21 occur, but the differences should be small and the cause for the
22 difference should be clearly identifiable."

1 Legislation introduced in 1996 noted "that small business
2 operations in Hawaii -- operations with 100 employees or less --
3 make up approximately ninety-eight per cent of the estimated
4 30,000 businesses operating in the State today. Small business
5 operations generate two out of every three new jobs in Hawaii
6 and disburse fifty-five per cent of the private workforce
7 payroll and further that the high cost of renegotiating lease
8 rents in Hawaii represents one of the major hurdles to the
9 continued growth of small business operations in the State. The
10 current formula for renegotiating lease rents which is based on
11 'highest and best use' of the property -- threatens to displace
12 those businesses that cannot afford to pay high increases in
13 lease rents."

14 After the "bubble" period created a problem, Anthony Downs,
15 Ph.D., senior fellow at the Brookings Institute, stated as
16 follows:

17 "There are two basic causes of these unexpectedly high
18 values. One is just the shortage of available and desirable
19 land in Hawaii - especially of fee simple land - in comparison
20 with the demand for it. This results in part from the general
21 prosperity of the Hawaiian economy, plus the widespread

1 ownership of land by a few big estates that have leased it to
2 lessees who subsequently built improvements on it.

3 "The second cause is the extraordinary influx of the
4 Japanese investment funds in the period from 1985-1989 that
5 drove land prices to levels unsustainable from economic uses
6 built on the land. Several circumstances affecting Japanese
7 investors were unprecedented and unique. As a result, Japanese
8 investors could and did pay huge prices for land that cannot be
9 supported by any conceivable uses put on that land. I will
10 refer to this period from 1985-1990 as the "Japanese bubble
11 period"."

12 The result was a series of land sales, or sales of both
13 land and improvements at extremely high prices. An example is
14 the sale of a downtown office site for \$1,200 per square foot --
15 when no previous site had ever sold for more than \$400 per
16 square foot.

17 Appraisers in Hawaii have used these sales as comparables
18 in lease renegotiations and arbitrations. The result is a
19 setting of land values so high that the rents based on those
20 values surpass the earning power of the improvements on the
21 land. They not only cannot be supported by the existing

1 improvements, but they also cannot be supported by any
2 improvements including the theoretically highest and best uses.

3 In Hawaii, when dealing specifically with real estate
4 values and real estate rental rates, the process of arbitration
5 has been a substantial contributor in creating the problems that
6 Hawaii's leasehold real estate is currently in. It has
7 substantially contributed to abuses in the Hawaii leasehold real
8 estate marketplace. To put a stop to these abuses, and remedy
9 this problem in Hawaii, when determining leasehold real estate
10 valuations and leasehold rental rates, the process of
11 arbitration needs to be replaced with the process of appraisal.

12 Fair rents based upon fair value was the purpose of Act
13 180, Session Laws of Hawaii 1998, of which the Committee on
14 Conference stated: "The purpose of this bill is to protect
15 consumers who lease land by requiring that the fair market value
16 of renegotiated rental amounts for lease be determined in
17 conformance with the Uniform Standards of Professional Appraisal
18 Practice." However, the legislature finds that there is a need
19 for additional clarification, since the legislature finds that
20 not all of the entities that are bound by that Act are currently
21 complying with the requirements of that Act.

1 In addition, the impact of the foregoing on Hawaii's people
2 also has been devastating. Thousands of jobs have been lost.
3 Workers who deserved pay increases have not been able to get
4 them. Jobs that should have been created have not been. Many
5 resident families are being divided, because children, husbands,
6 or wives are being forced to seek employment in other states.
7 Many local families whose entire effort for a generation has
8 been to build the equity in a business are losing the equity to
9 lease rents that are illegal. The creativity of Hawaii's people
10 is shackled because businesses are incapable of investing in new
11 creative ideas. Hawaii has been unable to diversify its economy
12 from tourism because long-term investment in leasehold
13 businesses has been rendered imprudent. The boom of the 1990s
14 -- the greatest economic boom in America's history -- completely
15 passed by the State. The impact on other sectors of the Hawaii
16 economy is also being felt. Public employee pay is falling
17 behind mainland standards because state government revenues have
18 stagnated, and the State is losing some of its brightest
19 citizens to more competitive states.

20 It is a critical public purpose to restore health to the
21 state economy, to encourage better businesses and jobs for our
22 people, and to reverse trends causing windfalls to lessors and

1 consequent losses to businesses. The leasing of property at
2 fair value based on the use to which the property is put is more
3 than ever critical to reversing economic trends that threaten
4 the welfare of nearly every sector of our State's economy. The
5 legislature finds this to be a compelling public purpose.

6 To achieve this goal requires enactment of remedies to
7 allow lessees to eliminate illegal and unreasonable practices
8 involved in past lease renegotiations. Therefore, the
9 legislature is acting to provide an appropriate basis for
10 Hawaii's lessee businesses and residences to assert the legal
11 rights they have held for many years. While such a change does
12 touch existing contracts between lessors and lessees, the
13 constitution does not prohibit this Act. First, where the
14 underlying contract is illegal, those provisions cannot be
15 enforced. This Act merely clarifies existing legal rights.

16 In 1969, the legislature passed what is now section 519-1,
17 Hawaii Revised Statutes. That statute provides that lease rent
18 renegotiations under all leases should be based on the use to
19 which property was put under the terms of the lease. The
20 purpose of this legislation was described in House Standing
21 Committee Report 745 in 1969:

1 ...The desirability of this bill is apparent, since uses not
2 allowed in a lease agreement would not be relevant to
3 setting the rental amount. The fact that the value of the
4 property has increased or decreased due to changes in
5 surrounding areas will not be taken into consideration in
6 renegotiation and problems which have arisen from this
7 consideration will be prevented....

8 Senate Standing Committee Report 701 in 1969 was even more
9 explicit:

10 The purpose of this bill is to require that in leases of
11 private lands for five or more years, which call for the
12 renegotiated rental amount during the term of the lease
13 that such renegotiated rental or other recompense be
14 calculated upon the value of the land based upon the uses
15 to which the lease permits of the land by the lessee and
16 not upon some higher priced use which the zoning laws
17 permit but which the terms of the lease do not permit.

18 As this legislative intent clearly indicates, the purpose
19 of rent setting was to achieve rents based on the uses to which
20 properties were put under terms of the lease, not based on "some
21 higher priced use".

1 Notwithstanding the foregoing, appraisers and arbitrators
2 have failed to properly follow or apply either the common law or
3 section 519-1 with the result that lease rents have been set so
4 high that many of Hawaii's finest businesses have staggered
5 under the burden. Yet because rents set by arbitrators cannot
6 be appealed, lessees have had no way to enforce their legal
7 rights.

8 The impact of the foregoing on Hawaii's economy has been
9 heavy indeed. Most business in Hawaii is conducted by
10 businesses who occupy leasehold premises. The impact on
11 businesses of excessive rents has robbed businesses of the
12 equity in their leasehold assets, made borrowing against those
13 assets impossible, rendered business leasehold assets
14 unsaleable, and thus in the great majority of cases, rendered
15 new investment in business in Hawaii imprudent. Businesses,
16 including many of Hawaii's finest businesses, have been exiting
17 Hawaii to other states. Businesses have been unable to update
18 plant and equipment to stay competitive and businesses either
19 scrape along at survival levels, or close. In fact, the
20 business impacts of the foregoing are accelerating at an
21 alarming rate, and it appears that the commercial leasehold real

1 estate market in Hawaii has collapsed, and the residential
2 leasehold market is near doing the same.

3 Finally, the city and county of Honolulu's Ordinance 91-95,
4 which provided a mechanism for converting leasehold interests in
5 condominium and cooperative units to fee interests through the
6 city's condemnation power, was subsequently upheld by the United
7 States Court of Appeals for the Ninth Circuit in Richardson v.
8 City and County of Honolulu, 124 F.3d 1150 (9th Cir. 1997),
9 cert. denied, 119 S.Ct. 168 (1998). In particular, the Court of
10 Appeals noted that in enacting that ordinance, the city found
11 that landowners had refused to sell proportionate shares in
12 their fee simple titles and that the few sales that occurred
13 involved exorbitant prices, and that this refusal to sell fee
14 simple titles, along with other factors, had caused a dramatic
15 increase in the price of housing in Honolulu.

16 The Ninth Circuit further noted the city's finding that
17 persons wishing to reside on Oahu were forced to sign long-term
18 leases that provide for periodic rent renegotiation. These
19 conditions led to "the acute recent inflation of land costs
20 (that) has adversely affected lease rent negotiations of persons
21 who have purchased leasehold multi-family units as their homes:
22 in some instances renegotiations have resulted in lease rents

1 that have increased over 1,000 percent. Under the burden of
2 increased lease rents, many owner-occupants of residential
3 condominium apartments..., especially those on fixed incomes,
4 have found, and will continue to find themselves unable to
5 afford to continue living in their homes."

6 Finally, the court noted the city's findings that these
7 defects in the housing market would adversely affect the city's
8 economy:

9 "There is a close relationship between the monetary values
10 accorded land on Oahu and the stability and strength of Oahu's
11 economy as a whole. Residential condominium ... land values,
12 artificially inflated by concentrated or single ownership,
13 market conditions or other factors, skew Oahu's economy toward
14 unnecessarily high levels. The pervasive and substantial
15 contribution made to inflation by high residential condominium
16 ... land values creates a potential for economic instability and
17 disruption on Oahu. Economic inflation, instability and
18 disruptions on Oahu have real and potential damaging
19 consequences for all members of an affected society."

20 The legislature similarly finds that there is a need to
21 reduce the potential for economic instability, not only on Oahu,
22 but with respect to the entire State. To accomplish the public

1 purpose of using and managing the property wisely, in the
2 community's interest requires changing the present practices
3 involved in leasing property.

4 The legislature finds that a one-time adjustment to the
5 current fair market value for ground leases affected by the
6 "Japanese Bubble" will alleviate the negative impact of that
7 unforeseen phenomenon while promoting the economy of the State
8 and the public interest, welfare, and security of its citizens.
9 Such an adjustment to existing ground leases would not be a
10 substantial impairment on contractual relationships since the
11 rent to be determined under the one-time adjustment would not be
12 lower than the rental amount determined in the period prior to
13 1985 and after the adjustment, the terms of the lease would
14 continue to govern future rent renegotiations. Allowing the
15 one-time adjustment would permit lessees to pay current market
16 rent (after years of paying above-market rent) and be
17 competitive in today's challenging economic times. This will
18 help to satisfy the pressing public necessity for a secure,
19 strong, and stable economy in Hawaii. Therefore, the
20 legislature finds that making the leasing of property viable for
21 lessees is a valid public purpose.

1 Residential lessees who own cooperative apartments are
2 similarly situated. Although chapter 38 of the Revised
3 Ordinances of Honolulu has given cooperative apartments owners
4 the right to seek mandatory conversion, no cooperative housing
5 corporation has been able to proceed under that law because they
6 have not been able to meet the eligibility requirements under
7 the ordinance and, practically speaking, cooperative apartment
8 lessees are unable to use the ordinance to obtain their leased-
9 fee interest.

10 The legislature therefore finds that there is a need to
11 alleviate the negative results of the "Japanese Bubble" by
12 allowing lessees under a long-term ground lease to lease at fair
13 market value the land on which their developments are sited.
14 Lease agreements generally contain a lease rent renegotiation
15 provision that utilizes real property appraisals to determine a
16 critical component in the renegotiation process, namely, the
17 fair market value of the land. Residential and commercial
18 leases are commonly structured whereby the fee simple owner
19 leases the land to the lessee, who as a sublessor then subleases
20 the land or a portion of the land to a sublessee. Leases
21 commonly prohibit a reduction in rent at renegotiation even
22 though a property appraisal determines that the lease rent based

1 on the land's fair market value is less than the current lease
2 rent. The legislature finds that it is in the public interest
3 that the lease rent and sublease rent should be based on the
4 fair market value of the land.

5 The legislature finds that there is a need to alleviate the
6 negative results of past violations of lessee's rights by
7 providing for lessees under long-term ground leases a right to
8 reestablish lease rents at fair rental value. These leases are
9 those in which renegotiated lease rents are based on prior
10 renegotiated lease rents, which serve as a rent floor under
11 which the cost of the lease can never drop. Some of these
12 leases also use formulas that drive up the cost of the lease
13 with every renegotiation, regardless of actual use or value.

14 The legislature finds that for lessors to receive a return
15 from property based upon the use to which the property is agreed
16 to be put is reasonable and proper, and is the basis on which
17 properties in practice were leased in Hawaii, and the
18 legislature further finds that rents established as set forth
19 above constitute unforeseen windfalls to lessors.

20 Accordingly, the purpose of this Act is to correct the
21 effect of the Japanese Bubble values on long-term ground leases
22 and to require that in future leasehold rent renegotiations the

1 rent is based on fair market value as determined by appraisal
2 under the Uniform Standards of Professional Appraisal Practice
3 (hereinafter "uniform standards").

4 Furthermore, any difference in appraised value shall be
5 resolved by an appraisal process that is in conformance with the
6 uniform standards and not by arbitration mandated by chapter
7 658, Hawaii Revised Statutes. Any appraisal or rent
8 determination that does not follow the uniform standards will be
9 subject to being set aside by a circuit court if a civil action
10 is initiated.

11 While such a change does affect existing contracts between
12 lessors and lessees, these contracts are not paramount to the
13 State's power to protect its citizens. In Home Building & Loan
14 Association v. Blaisdell, 290 U.S. 398, the United States
15 Supreme Court upheld against a contract clause attack a mortgage
16 moratorium law that Minnesota had enacted to provide relief for
17 homeowners threatened with foreclosure during the Depression.
18 In its decision upholding the Minnesota law, the Court said:
19 "It is the settled law of this court that the interdiction of
20 statutes impairing the obligation of contracts does not prevent
21 the State from exercising such powers as are vested in it for
22 the promotion of the common weal; or are necessary for the

1 general good of the public, though contracts previously entered
2 into between individuals may thereby be affected."

3 SECTION 2. The Hawaii Revised Statutes is amended by
4 adding a new chapter to be appropriately designated and to read
5 as follows:

6 "CHAPTER

7 REAL PROPERTY LEASE CONTRACTS

8 § -1 Definitions. As used in this chapter, unless the
9 context clearly requires otherwise:

10 "Fee owner" means the person who owns the fee simple title
11 to the real property leased under a property development and the
12 person's heirs, successors, legal representatives, and assigns.

13 "Lease" means the same as in section 519-1.

14 "Leased fee" and "leased fee interest" means reversionary
15 interests of the fee owner, lessor, and all legal and equitable
16 owners of land that are leased, other than the lessee's or a
17 sublessee's interest.

18 "Legal and equitable owners" means the fee simple owners
19 and all persons having legal or equitable ownership interests in
20 the leased fee or in the lessor's leasehold estate, including
21 mortgagees, developers, lienors, and sublessors, and their

1 respective heirs, successors, legal representatives, and
2 assigns.

3 "Lessee" means any person who leases or subleases land from
4 another, and the person's heirs, successors, legal
5 representatives, and assigns.

6 "Lessor" means any person who leases or subleases land to
7 another, and the person's heirs, successors, legal
8 representatives, and assigns.

9 "Lessors", "lessees", "fee owners", and "legal and
10 equitable owners" include individuals, both masculine and
11 feminine; corporations, firms, associations, partnerships,
12 limited liability companies, trusts, and estates; and the State
13 of Hawaii and any county or other political subdivision of the
14 State. When more persons than one are the lessors, lessees, fee
15 owners, or legal and equitable owners of a lot, the terms apply
16 to each of them, jointly and severally.

17 "Uniform standards" means the current Uniform Standards of
18 Professional Appraisal Practice approved by the director of
19 commerce and consumer affairs pursuant to section 466K-4(a).

20 § -2 **Lease renegotiations; calculation of rent;**
21 **definition.** Whenever any agreement or document for the lease of
22 private lands provides for the renegotiation of the rental

1 amount or other recompense during the term of the lease, and the
2 renegotiated rental amount or other recompense is based,
3 according to the terms of the lease, in whole or in part upon
4 the fair market value of the land, or the value of the land as
5 determined by its highest and best use, or words of similar
6 import, such value, for the purposes of determining the amount
7 of rental or other recompense, shall be calculated upon the use
8 to which the land is restricted by the lease document; provided
9 that:

- 10 (1) Fair market value shall be determined in conformance
11 with the uniform standards;
- 12 (2) Any disputes over value shall be settled by procedures
13 under this chapter and not by arbitration; and
- 14 (3) Any other provision or remedy afforded any class of
15 lessee in this chapter or in any other law relating to
16 the lease of real property shall be equally available
17 to all lessees; and no provision, right, benefit, or
18 remedy afforded to any class of lessee or tenant by
19 this chapter or in any other law or rule shall be
20 denied to any other class, lessee, or tenant.

1 § -3 **Rules.** The housing and community development
2 corporation of Hawaii shall adopt rules pursuant to chapter 91
3 as may be necessary to implement this chapter.

4 § -4 **Applicability.** This chapter applies to all ground
5 leases that were in existence prior to January 1, 1985.

6 § -5 **One-time rent adjustment.** (a) Any ground lease in
7 existence on the effective date of this chapter that has been
8 renegotiated after January 1, 1990, shall be allowed a one-time
9 adjustment upon application of the lessor or lessee to reflect
10 fair market rental value as determined by a real property
11 appraisal in conformance with the uniform standards; provided
12 that the adjusted rent under this section shall not be lower
13 than the rental amount negotiated pursuant to the lease prior to
14 January 1, 1985. This adjustment shall be a one-time correction
15 to the lease and shall prevail over any existing contract
16 provision to the contrary. The new adjusted rent shall be
17 prospective and shall become effective upon the determination of
18 the fair market rental value as determined by the appraisal. To
19 the extent that the lease rent amount is reduced pursuant to
20 this subsection, a sublessor shall promptly adjust any sublease
21 to a sublessee for the premises or portion thereof covered by
22 the sublease to the extent necessary to achieve fair market

1 rent. This subsection shall be automatically repealed on
2 December 31, 2006 or three years after a final court decision
3 upholding the validity of this chapter in the event the validity
4 of this section is challenged, whichever occurs later.

5 (b) At the option of either party, any disagreement over
6 fair market value that cannot be resolved by negotiation shall
7 be settled by an appraisal process that is in conformance with
8 the uniform standards, and shall not be subject to arbitration
9 under chapter 658.

10 If a party does not agree with the value produced, that
11 party may appoint and pay for the services of an appraiser of
12 its choice, who shall perform an appraisal. If the two
13 appraisers cannot resolve the differing valuations, a third
14 appraiser shall be appointed by mutual agreement to review the
15 work done or, failing agreement, by the senior judge of the
16 circuit court of the circuit in which the real property is
17 located, and the issue shall be settled by a decision of two of
18 the three appraisers. The two appraisers shall provide in
19 writing their findings, conclusions, methodology, and reasoning
20 clearly showing how they arrived at their decision. The cost of
21 the third appraiser shall be divided and paid equally by the
22 lessee and lessor.

1 (c) As used in this section, "ground lease" means a lease
2 of privately-owned land in which a lessee leases the land only or
3 leases the land and infrastructure for a term of twenty years or
4 more, including extensions and renewals.

5 § -6 **Priority.** If this chapter conflicts with another
6 state law, this chapter shall prevail.

7 § -7 **Severability.** If any provision of this Act, or the
8 application thereof to any person or circumstance is held
9 invalid, the invalidity does not affect other provisions or
10 applications of the Act, which can be given effect without the
11 invalid provision or application, and to this end the provisions
12 of this Act are severable."

13 SECTION 3. Section 519-1, Hawaii Revised Statutes, is
14 amended to read as follows:

15 "[~~†~~§519-11~~†~~] **Lease renegotiations; calculation of rent;**
16 **definition.** (a) Whenever any agreement or document for the
17 lease of private lands provides for the renegotiation of the
18 rental amount or other recompense during the term of the lease
19 and [~~such~~] that renegotiated rental amount or other recompense
20 is based, according to the terms of the lease, in whole or in
21 part upon the fair market value of the land, or the value of the
22 land as determined by its highest and best use, or words of

1 similar import, [~~such~~] the value, for the purposes of
2 determining the amount of rental or other recompense, shall be
3 calculated upon the use to which the land is restricted by the
4 lease document [-

5 ~~(b) The term "lease";~~ provided that provisions of this
6 chapter are superseded by chapter _____.

7 (b) As used in this section:

8 "Lease", "lease agreement", or "document" [as used in this
9 section]; means a conveyance leasing privately-owned land by a
10 fee simple owner as lessor, or by a lessee as sublessor, to any
11 person, for a term exceeding five years, in consideration of a
12 return of rent or other recompense[-], and, for purposes of
13 determining renegotiated rents, shall include any related
14 documents including offers to lease, applications, or documents
15 of similar import which show agreement or understanding as to
16 the use to which property would be put under a lease."

17 SECTION 4. If any provision of this Act, or the
18 application thereof to any person or circumstance is held
19 invalid, the invalidity does not affect other provisions or
20 applications of the Act, which can be given effect without the
21 invalid provision or application, and to this end the provisions
22 of this Act are severable.

S.B. NO. 905

1 SECTION 5. Statutory material to be repealed is bracketed
2 and stricken. New statutory material is underscored.

3 SECTION 6. This Act shall take effect on July 1, 2003.
4

INTRODUCED BY: Erzanne Chun Oakland
Carmel Fukuoka
Hedden Jr
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Linda L. Lanning

SB905

Report Title:

Real Property Leases; Renegotiation

Description:

Requires, in leasehold renegotiations, that a rent based on fair market value shall apply even if that value is lower than existing rent and the lease contract bars the lowering of rent upon renegotiation. Allows a one-time rent adjustment to reflect fair market value for any existing lease renegotiated after 1/1/90.

Appendix M

**THE CONCENTRATION OF LAND
OWNERSHIP ON OAHU, RELATIVE
TO FEE SIMPLE AND LEASEHOLD
TENANCY**

*FOR PROPERTIES DESIGNATED PITT 400,
INDUSTRIAL/COMMERCIAL USAGE*

**FOR
HAWAII PUBLIC INTEREST ADVOCATE**

**BY
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15 November 2003

OVERALL**(All Oahu, Zones 1-1 through 1-9), for PITT 400**

	FEE PARCELS	LEASEHOLD	Grand Total
Count of Parcels	1,748	1,556	3,304
Total of Assessed Value	1,985,785,100	1,888,288,500	3,874,073,600
Total of TMK Land area	126,085,789	54,053,607	180,139,396

Percentage of Total Market (Market Share)

	Fee	Leasehold
Parcels	52.9%	47.1%
Accessed Value	51.3%	48.7%
Land Area	70.0%	30.0%
Accessed Value/SqFt	\$ 15.75	\$ 34.93

(Note: the following table has been modified by assigning all lands owned by the Estate of James Campbell to be leasehold, under the land tenure definition).

(All Oahu, Zones 1-1 through 1-9), for PITT 400

	FEE PARCELS	LEASEHOLD	Grand Total
Count of Parcels	1,657	1,647	3,304
Total of Assessed Value	1,887,302,600	1,986,771,000	3,874,073,600
Total of TMK Land area	71,714,257	108,425,139	180,139,396

Percentage of Total Market (Market Share)

	Fee	Leasehold
Parcels	50.2%	49.8%
Accessed Value	48.7%	51.3%
Land Area	39.8%	60.2%
Accessed Value/SqFt	\$26.32	\$18.32

SUB-MARKETS

(All Oahu, Zones 1-1, 1-2, 1-3, 1-4 And 1-9), for PITT 400

	FEE PARCELS	LEASEHOLD	Grand Total
Count of Parcels	1,623	1,643	3,266
Total of Assessed Value	1,869,868,300	1,983,314,100	3,853,182,400
Total of TMK Land area	68,642,808	107,513,647	176,156,455

Percentage of Total Market (Market Share)

	Fee	Leasehold
Parcels	49.7%	50.3%
Assessed Value	48.5%	51.5%
Land Area	39.0%	61.0%
Assessed Value/SqFt	\$ 27.24	\$ 18.45

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP, FOR SUB-MARKET,
(ZONE 1-1, 1-2, 1-3, 1-4 And 1-9), FOR PITT 400

TOTAL	LEASEHD	FEE/SIM	TMK Owner/Lessor	% Total	Top 5
841	819	22	STATE OF HAWAII	25.76%	38.79%
164	150	14	DAMON,SAMUEL M TR EST	5.02%	
126	126	-	JAMES CAMPBELL TRUST EST	3.86%	
95	86	9	B P BISHOP ESTATE	2.91%	
41	-	41	HNK INC	1.26%	
39	26	13	VICTORIA WARD LIMITED	1.19%	
37	1	36	CIRI LAND DEV CO	1.13%	
36	31	5	LOYALTY DEVELOPMENT CO LTD	1.10%	
35	24	11	AAE LTD	1.07%	
26	-	26	WEDEMAN,D V TRS	0.80%	
25	20	5	TAIHOOK ASSOCIATES	0.77%	
24	24	-	EUROPA HOLDINGS INC	0.74%	
21	21	-	HAWAIIAN HOME LANDS	0.64%	
21	-	21	GENTRY PROPERTIES	0.64%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP, FOR SUB-
MARKET, (ZONE 1-1, 1-2, 1-3, 1-4 And 1-9), FOR PITT 400

LEASEHD	TMK Owner/Lessor	% Leasehd	Top 5 %
819	STATE OF HAWAII	49.88%	73.83%
150	DAMON,SAMUEL M TR EST	9.14%	
126	JAMES CAMPBELL TRUST EST	7.67%	
86	B P BISHOP ESTATE	5.24%	
31	LOYALTY DEVELOPMENT CO LTD	1.89%	
26	VICTORIA WARD LIMITED	1.58%	
24	AAE LTD	1.46%	
24	EUROPA HOLDINGS INC	1.46%	
21	HAWAIIAN HOME LANDS	1.28%	
20	TAIHOOK ASSOCIATES	1.22%	
20	K J L ASSOCIATES	1.22%	
18	HAWAII COMM DEV AUTHORITY	1.10%	
12	HARRY/JEANETTE WEINBERG FDN	0.73%	
9	CASTLE FAM LTD PARTNERSHIP	0.64%	

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP BY ACCESSED VALUES,
FOR SUB-MARKET, (ZONE 1-1, 1-2, 1-3, 1-4 And 1-9), FOR PITT 400

Note that the top five owners have 36.93% of market share.

TOTAL	LEASEHD	FEE/SIM	TMK OWNER/LESSOR	% Total
\$501,067,200	\$491,274,000	\$9,793,200	STATE OF HAWAII	13.00%
\$365,723,600	\$339,810,600	\$25,913,000	DAMON,SAMUEL M TR EST	9.49%
\$226,639,500	\$186,560,700	\$40,078,800	B P BISHOP ESTATE	5.88%
\$193,823,700	\$193,823,700	\$0	JAMES CAMPBELL TRUST EST	5.03%
\$135,871,400	\$128,010,300	\$7,861,100	LOYALTY DEVELOPMENT CO LTD	3.53%
\$107,730,800	\$82,138,500	\$25,592,300	VICTORIA WARD LIMITED	2.80%
\$94,726,600	\$0	\$94,726,600	CHEVRON U S A INC	2.46%
\$73,731,400	\$51,761,600	\$21,969,800	CASTLE & COOKE PROP INC	1.91%
\$51,520,600	\$0	\$51,520,600	TESORO HAWAII CORP	1.34%
\$50,482,900	\$43,208,000	\$7,274,900	TAIHOOK ASSOCIATES	1.31%
\$48,810,800	\$48,810,800	\$0	K J L ASSOCIATES	1.27%
\$40,501,300	\$30,535,900	\$9,965,400	HARRY/JEANETTE WEINBERG FDN	1.05%
\$34,115,900	\$0	\$34,115,900	BANK OF HAWAII	0.89%
\$31,348,200	\$0	\$31,348,200	FIRST HAWAIIAN BANK	0.81%
\$30,985,300	\$0	\$30,985,300	ZIPPY'S INC	0.80%
\$30,082,600	\$0	\$30,082,600	COSTCO WHOLESALE CORP	0.78%

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP BY ACCESSED
VALUES, FOR SUB-MARKET, (ZONE 1-1, 1-2, 1-3, 1-4 And 1-9), FOR PITT
400

Note that the top five owners have 71.74% of market share.

FEE/SIM	TMK OWNER/LESSOR	% Leased
\$491,274,000	STATE OF HAWAII	25.26%
\$339,810,600	DAMON,SAMUEL M TR EST	18.44%
\$193,823,700	JAMES CAMPBELL TRUST EST	11.43%
\$186,560,700	B P BISHOP ESTATE	9.77%
\$128,010,300	LOYALTY DEVELOPMENT CO LTD	6.85%
\$82,138,500	VICTORIA WARD LIMITED	5.43%
\$51,761,600	CASTLE & COOKE PROP INC	4.78%
\$48,810,800	K J L ASSOCIATES	3.72%
\$43,208,000	TAIHOOK ASSOCIATES	2.60%
\$30,535,900	HARRY/JEANETTE WEINBERG FDN	2.55%
\$27,469,900	HAWAIIAN HOME LANDS	2.46%
\$18,346,200	HAWAII COMM DEV AUTHORITY	2.04%
\$15,415,400	B&M INVESTMENT INC	1.72%
\$15,156,200	300 CORP	1.58%
\$15,078,400	HONOLULU LIMITED	1.56%
\$13,336,700	BLACK DEVELOPMENT CORP	1.52%
\$10,553,800	PACIFIC WAREHOUSE INC	1.49%
\$10,080,700	G2000 PROPERTY CORP	1.43%
\$9,282,900	A G O FAMILY LTD PART	1.39%

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP BY SQUARE FOOTAGE,
FOR SUB-MARKET, (ZONE 1-1, 1-2, 1-3, 1-4 And 1-9), FOR PITT 400

Note that the top five owners have 61.13% of market share.

TOTAL	LEASEHD	FEE/SIM	TMK OWNER/LESSOR	% Total
69,681,192	15,309,660	54,371,532	JAMES CAMPBELL TRUST EST	39.6%
12,819,460	12,632,659	186,801	STATE OF HAWAII	7.3%
11,582,041	-	11,582,041	CHEVRON U S A INC	6.6%
7,858,014	7,197,883	660,131	DAMON, SAMUEL M TR EST	4.5%
5,717,771	-	5,717,771	TESORO HAWAII CORP	3.2%
5,384,321	-	5,384,321	HRT LTD	3.1%
3,675,753	2,972,358	703,395	B P BISHOP ESTATE	2.1%
2,477,547	2,472,547	5,000	CITY & COUNTY OF HONOLULU	1.4%
2,391,660	39,800	2,351,860	CIRI LAND DEV CO	1.4%
1,674,617	-	1,674,617	BANK OF HAWAII	1.0%
1,570,490	1,375,290	195,200	LOYALTY DEVELOPMENT CO LTD	0.9%
1,435,396	915,251	520,145	VICTORIA WARD LIMITED	0.8%
1,326,344	-	1,326,344	A & B PROPERTIES INC	0.8%
1,294,560	-	1,294,560	HAWAIIAN CEMENT	0.7%
1,182,653	-	1,182,653	ROADS LLC	0.7%
1,107,671	513,006	594,665	CASTLE & COOKE PROP INC	0.6%
990,663	990,663	-	K J L ASSOCIATES	0.6%
969,776	969,776	-	BALDWIN, MICHAEL C TR /ETAL	0.6%
956,909	835,956	120,953	TAIHOOK ASSOCIATES	0.5%
846,153	-	846,153	COSTCO WHOLESALE CORP	0.5%
793,602	-	793,602	SERVCO PACIFIC INC	0.5%
766,808	-	766,808	HAWAIIAN ELECTRIC CO INC	0.4%
729,630	-	729,630	AMERON INTERNATIONAL CORP	0.4%
726,723	567,787	158,936	HARRY/JEANETTE WEINBERG FDN	0.4%
701,403	-	701,403	QUEEN EMMA FOUNDATION	0.4%
691,707	-	691,707	AMFAC PROPERTY DEV CORP	0.4%
640,426	-	640,426	TOSCO CORPORATION	0.4%
577,636	304,920	272,716	PACIFIC WAREHOUSE INC	0.3%

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP BY SQUARE
FOOTAGE, FOR SUB-MARKET, (ZONE 1-1, 1-2, 1-3, 1-4 And 1-9), FOR PITT
400

Note that the top five owners have 76.44% of market share.

LEASEHD	TMK OWNER/LESSOR	% Leased	Top 5
69,681,192	JAMES CAMPBELL TRUST EST	64.8%	76.44%
12,632,659	STATE OF HAWAII	11.7%	
7,197,883	DAMON,SAMUEL M TR EST	6.7%	
2,972,358	B P BISHOP ESTATE	2.8%	
2,472,547	CITY & COUNTY OF HONOLULU	2.3%	
1,375,290	LOYALTY DEVELOPMENT CO LTD	1.3%	
990,663	K J L ASSOCIATES	0.9%	
969,776	BALDWIN,MICHAEL C TR /ETAL	0.9%	
915,251	VICTORIA WARD LIMITED	0.9%	
835,956	TAIHOOK ASSOCIATES	0.8%	
567,787	HARRY/JEANETTE WEINBERG FDN	0.5%	
567,611	HAWAIIAN HOME LANDS	0.5%	
513,006	CASTLE & COOKE PROP INC	0.5%	
472,915	HAWAII COMM DEV AUTHORITY	0.4%	
397,354	CAMPBELL WATUMULL LLC	0.4%	
304,920	PACIFIC WAREHOUSE INC	0.3%	
235,783	BLACK DEVELOPMENT CORP	0.2%	
230,880	300 CORP	0.2%	
186,900	B&M INVESTMENT INC	0.2%	

SUB-MARKETS SEGMENTED BY ZONES**Zone 1-1 only, for PITT 400**

	FEE PARCELS	LEASEHOLD	Grand Total
Count of Parcels	1,032	1,316	2,348
Total of Assessed Value	895,768,000	1,460,996,700	2,356,764,700
Total of TMK Land area	14,505,339	28,876,104	43,381,443

Percentage of Total Market (Market Share)

	Fee	Leasehold
Parcels	44.0%	56.0%
Accessed Value	38.0%	62.0%
Land Area	33.4%	66.6%
Accessed Value/SqFt	\$ 61.75	\$ 50.60

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP, FOR SUB-MARKET,
(ZONE 1-1), FOR PITT 400

Total	Leasehold	Fee Simple	TMK Owner/Lessor	% Total	Top 5 %
818	796	22	STATE OF HAWAII	34.84%	47.32%
163	149	14	DAMON,SAMUEL M TR EST	6.94%	
53	48	5	B P BISHOP ESTATE	2.26%	
41	-	41	HNK INC	1.75%	
36	31	5	LOYALTY DEVELOPMENT CO LTD	1.53%	
35	24	11	AAE LTD	1.49%	
26	-	26	WEDEMAN,D V TRS	1.11%	
25	20	5	TAIHOOK ASSOCIATES	1.06%	
24	24	-	EUROPA HOLDINGS INC	1.02%	
21	21	-	HAWAIIAN HOME LANDS	0.89%	
20	20	-	K J L ASSOCIATES	0.85%	
17	-	17	UNITED FOOD INCORPORATED	0.72%	
15	12	3	HARRY/JEANETTE WEINBERG FDN	0.64%	
13	-	13	HAWAIIAN HOST INC	0.55%	
11	-	11	KAO,PAUL K F	0.47%	
11	-	11	WALTZ ENGINEERING INC	0.47%	
11	-	11	ZIPPY'S INC	0.47%	
8	1	7	YEE HOP REALTY LTD	0.34%	
7	-	7	AHN,VICTOR J/JOYCE J	0.30%	
7	2	5	CASTLE & COOKE PROP INC	0.30%	
6	1	5	ASN ENTERPRISES	0.26%	
6	-	6	DANG,WENDELL C/AILEEN Y F L	0.26%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP, FOR SUB-MARKET, (ZONE 1-1), FOR PITT 400

Leasehold	Fee Simple	TMK Owner/Lessor	% Leased	Top 5 %
796	22	STATE OF HAWAII	60.49%	79.64%
149	14	DAMON,SAMUEL M TR EST	11.32%	
48	5	B P BISHOP ESTATE	3.65%	
31	5	LOYALTY DEVELOPMENT CO LTD	2.36%	
24	11	AAE LTD	1.82%	
24	-	EUROPA HOLDINGS INC	1.82%	
21	-	HAWAIIAN HOME LANDS	1.60%	
20	5	TAIHOOK ASSOCIATES	1.52%	
20	-	K J L ASSOCIATES	1.52%	
12	3	HARRY/JEANETTE WEINBERG FDN	0.91%	
6	-	HOLT,GEORGE H EST	0.46%	
6	-	KASHIWA,GENRO TRUSTEE	0.46%	
5	-	M MILNER WOND TRUSTEE	0.38%	
4	2	HONOLULU LIMITED	0.30%	
4	-	KIMURA FAMILY PARTNERS	0.30%	
3	1	RICHARDS LTD	0.23%	
3	1	WOND,M MILNER TRUSTEE	0.23%	
3	-	HONBO,EARL Y/KAREN Y	0.23%	

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP BY ACCESSED VALUES,
FOR SUB-MARKET, (ZONE 1-1), FOR PITT 400

Total	Leasehold	Fee Simple	TMK Owner/Lessor	% Total	Top 5 %
\$ 494,796,700	\$ 485,003,500	\$ 9,793,200	STATE OF HAWAII	20.99%	51.30%
\$ 364,111,700	\$ 338,198,700	\$ 25,913,000	DAMON,SAMUEL M TR EST	15.45%	
\$ 140,609,000	\$ 117,434,600	\$ 23,174,400	B P BISHOP ESTATE	5.97%	
\$ 135,871,400	\$ 128,010,300	\$ 7,861,100	LOYALTY DEVELOPMENT CO LTD	5.77%	
\$ 73,731,400	\$ 51,761,600	\$ 21,969,800	CASTLE & COOKE PROP INC	3.13%	
\$ 50,482,900	\$ 43,208,000	\$ 7,274,900	TAIHOOK ASSOCIATES	2.14%	
\$ 48,810,800	\$ 48,810,800	\$ -	K J L ASSOCIATES	2.07%	
\$ 40,501,300	\$ 30,535,900	\$ 9,965,400	WEINBERG FDN	1.72%	
\$ 31,348,200	\$ -	\$ 31,348,200	FIRST HAWAIIAN BANK	1.33%	
\$ 28,374,100	\$ -	\$ 28,374,100	TOSCO CORPORATION	1.20%	
\$ 27,469,900	\$ 27,469,900	\$ -	HAWAIIAN HOME LANDS	1.17%	
\$ 25,903,800	\$ -	\$ 25,903,800	SERVCO PACIFIC INC	1.10%	
\$ 21,114,400	\$ -	\$ 21,114,400	CHEVRON U S A INC	0.90%	
\$ 19,587,500	\$ -	\$ 19,587,500	ROBINSON,MARK A/MARY K H TR	0.83%	
\$ 15,510,100	\$ 15,156,200	\$ 353,900	300 CORP	0.66%	
\$ 15,113,900	\$ 1,555,000	\$ 13,558,900	YEE HOP REALTY LTD	0.64%	
\$ 15,078,600	\$ 15,078,400	\$ 200	HONOLULU LIMITED	0.64%	
\$ 13,934,400	\$ 13,336,700	\$ 597,700	BLACK DEVELOPMENT CORP	0.59%	
\$ 13,711,400	\$ -	\$ 13,711,400	ZIPPY'S INC	0.58%	
\$ 13,205,700	\$ -	\$ 13,205,700	HY-PAC STORAGE INC	0.56%	
\$ 13,034,800	\$ -	\$ 13,034,800	BANK OF HAWAII	0.55%	
\$ 12,702,100	\$ -	\$ 12,702,100	TROY CMBS PROPERTY LLC	0.54%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP BY ACCESSED
VALUES, FOR SUB-MARKET, (ZONE 1-1), FOR PITT 400

Leasehold	Fee Simple	TMK Owner/Lessor	% Leased	Top 5
\$ 485,003,500	\$ 9,793,200	STATE OF HAWAII	33.20%	76.69%
\$ 338,198,700	\$ 25,913,000	DAMON,SAMUEL M TR EST	23.15%	
\$ 128,010,300	\$ 7,861,100	LOYALTY DEVELOPMENT CO LTD	8.76%	
\$ 117,434,600	\$ 23,174,400	B P BISHOP ESTATE	8.04%	
\$ 51,761,600	\$ 21,969,800	CASTLE & COOKE PROP INC	3.54%	
\$ 48,810,800	\$ -	K J L ASSOCIATES	3.34%	
\$ 43,208,000	\$ 7,274,900	TAIHOOK ASSOCIATES	2.96%	
\$ 30,535,900	\$ 9,965,400	HARRY/JEANETTE WEINBERG FDN	2.09%	
\$ 27,469,900	\$ -	HAWAIIAN HOME LANDS	1.88%	
\$ 15,156,200	\$ 353,900	300 CORP	1.04%	
\$ 15,078,400	\$ 200	HONOLULU LIMITED	1.03%	
\$ 13,336,700	\$ 597,700	BLACK DEVELOPMENT CORP	0.91%	
\$ 9,282,900	\$ -	A G O FAMILY LTD PART	0.64%	
\$ 8,538,500	\$ -	HOLT,GEORGE H EST	0.58%	
\$ 4,954,700	\$ -	J T B OVERSEAS DEV CORP	0.34%	
\$ 4,611,100	\$ -	MULLIN,SYLVIA A TR /ETAL	0.32%	
\$ 4,485,800	\$ -	M MILNER WOND TRUSTEE	0.31%	
\$ 3,774,900	\$ -	CONSOLIDATED AMUSEMENT CO	0.26%	
\$ 3,680,100	\$ -	LENAKONA DEVELOPMENT LTD	0.25%	
\$ 3,003,500	\$ -	SASAKI,RAYMOND T /ETAL	0.21%	
\$ 2,693,700	\$ -	YAMADA,GILBERT Y /ETAL	0.18%	
\$ 2,633,000	\$ -	KAHAI ST INVEST LTD PTN	0.18%	
\$ 2,486,500	\$ -	HOLADERO CORPORATION	0.17%	
\$ 2,443,900	\$ -	LENAKOA DEVELOPMENT LTD	0.17%	
\$ 2,168,400	\$ -	FAN,JENTER/SANDRA NAOMI	0.15%	
\$ 2,087,300	\$ -	IZAWA,RICHARD K /ETAL	0.14%	

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP BY SQUARE FOOTAGE,
FOR SUB-MARKET, (ZONE 1-1), FOR PITT 400

Total	Leasehold	Fee Simple	TMK Owner/Lessor	% Total	Top 5 %
12,658,759	12,471,958	186,801	STATE OF HAWAII	29.18%	58.68%
7,814,485	7,154,354	660,131	DAMON,SAMUEL M TR EST	18.01%	
2,304,484	1,810,605	493,879	B P BISHOP ESTATE	5.31%	
1,570,490	1,375,290	195,200	LOYALTY DEVELOPMENT CO LTD	3.62%	
1,107,671	513,006	594,665	CASTLE & COOKE PROP INC	2.55%	
990,663	990,663	-	K J L ASSOCIATES	2.28%	
956,909	835,956	120,953	TAIHOOK ASSOCIATES	2.21%	
726,723	567,787	158,936	HARRY/JEANETTE WEINBERG FDN	1.68%	
640,426	-	640,426	TOSCO CORPORATION	1.48%	
629,311	-	629,311	SERVCO PACIFIC INC	1.45%	
567,611	567,611	-	HAWAIIAN HOME LANDS	1.31%	
497,281	-	497,281	ROBINSON,MARK A/MARY K H TR	1.15%	
471,995	50,649	421,346	YEE HOP REALTY LTD	1.09%	
341,994	-	341,994	CHEVRON U S A INC	0.79%	
292,244	-	292,244	ROBERT'S TOURS & TRANS	0.67%	
250,783	235,783	15,000	BLACK DEVELOPMENT CORP	0.58%	
239,294	230,880	8,414	300 CORP	0.55%	
236,531	-	236,531	REAL ESTATE DELIVERY INC	0.55%	
232,993	-	232,993	HY-PAC STORAGE INC	0.54%	
229,603	159,453	70,150	HONOLULU LIMITED	0.53%	
210,919	-	210,919	H & J WEINBERG FNDTN INC	0.49%	
208,220	-	208,220	ZIPPY'S INC	0.48%	
193,388	-	193,388	CITY MILL CO LTD	0.45%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP BY SQUARE
FOOTAGE, FOR SUB-MARKET, (ZONE 1-1), FOR PITT 400

Leasehold	Fee Simple	TMK Owner/Lessor	% Leased	Top 5 %
12,471,958	186,801	STATE OF HAWAII	43.19%	82.43%
7,154,354	660,131	DAMON,SAMUEL M TR EST	24.78%	
1,810,605	493,879	B P BISHOP ESTATE	6.27%	
1,375,290	195,200	LOYALTY DEVELOPMENT CO LTD	4.76%	
990,663	-	K J L ASSOCIATES	3.43%	
835,956	120,953	TAIHOOK ASSOCIATES	2.89%	
567,787	158,936	HARRY/JEANETTE WEINBERG FDN	1.97%	
567,611	-	HAWAIIAN HOME LANDS	1.97%	
513,006	594,665	CASTLE & COOKE PROP INC	1.78%	
235,783	15,000	BLACK DEVELOPMENT CORP	0.82%	
230,880	8,414	300 CORP	0.80%	
159,453	70,150	HONOLULU LIMITED	0.55%	
137,737	-	A G O FAMILY LTD PART	0.48%	
93,824	-	HOLT,GEORGE H EST	0.32%	
85,518	-	MULLIN,SYLVIA A TR /ETAL	0.30%	
70,802	-	M MILNER WOND TRUSTEE	0.25%	
59,371	-	LENAKOA DEVELOPMENT LTD	0.21%	
55,848	-	LENAKONA DEVELOPMENT LTD	0.19%	
54,808	-	HOLADERO CORPORATION	0.19%	
52,941	-	CONSOLIDATED AMUSEMENT CO	0.18%	

Zone 1-2 only, for PITT 400

	FEE PARCELS	LEASEHOLD	Grand Total
Count of Parcels	181	103	284
Total of Assessed Value	183,187,500	200,794,500	383,982,000
Total of TMK Land area	2,171,772	2,388,645	4,560,417

Percentage of Total Market (Market Share)

	Fee	Leasehold
Parcels	63.7%	36.3%
Accessed Value	47.7%	52.3%
Land Area	47.6%	52.4%
Accessed Value/SqFt	\$ 84.35	\$ 84.06

**BREAKDOWN OF TOTAL PROPERTY OWNERSHIP, FOR SUB-MARKET,
(ZONE 1-2), FOR PITT 400**

Totals	LEASEHLD	FEES	TMK Owner/Lessor	% Total	Top 5 %
39	26	13	VICTORIA WARD LIMITED	13.73%	30.28%
19	18	1	HAWAII COMM DEV AUTHORITY	6.69%	
12	12	-	STATE OF HAWAII	4.23%	
11	8	3	B P BISHOP ESTATE	3.87%	
5	-	5	HAWAII OPERA THEATRE	1.76%	
5	-	5	SMK INC	1.76%	
3	-	3	CHING FAM ENT LTD PART	1.06%	
3	-	3	KOMODA,WILLIAM M TRUST /ETAL	1.06%	
3	-	3	ZOBEL,DEE A H TR	1.06%	
2	-	2	510 PIIKOI LLC	0.70%	
2	-	2	A C LYAU CO LTD	0.70%	
2	1	1	ASANOMA,FAMILY TRUST	0.70%	
2	-	2	BRODCO LTD PARTNERSHIP	0.70%	
2	-	2	CHEN,MING TR /ETAL	0.70%	
2	2	-	CITY & COUNTY OF HONOLULU	0.70%	
2	-	2	COOPER,KATHERINE M TRUST	0.70%	
2	-	2	DIAMOND PARKING INC	0.70%	
2	2	-	FUJI SAKE BREWING CO LTD	0.70%	
2	-	2	FUJII,JANET H TR	0.70%	
2	-	2	HAMADA,HIROSHI TRUSTEE /ETAL	0.70%	
2	1	1	HAWN SECURITIES & RLTY LTD	0.70%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP, FOR SUB-MARKET, (ZONE 1-2), FOR PITT 400

Totals	Leasehold	Fee Simple	TMK Owner/Lessor	% Leased	Top 5 %
39	26	13	VICTORIA WARD LIMITED	25.24%	64.08%
19	18	1	HAWAII COMM DEV AUTHORITY	17.48%	
12	12	-	STATE OF HAWAII	11.65%	
11	8	3	B P BISHOP ESTATE	7.77%	
2	2	-	CITY & COUNTY OF HONOLULU	1.94%	
2	2	-	FUJI SAKE BREWING CO LTD	1.94%	
2	2	-	HSG & COMM DEV CORP OF HI	1.94%	
2	2	-	KAGAWA,MASAO TRUST /ETAL	1.94%	
2	2	-	SCHULTZ,JENS R TR /ETAL	1.94%	
2	1	1	ASANOMA,FAMILY TRUST	0.97%	
2	1	1	HAWN SECURITIES & RLTY LTD	0.97%	
2	1	1	ING,JOHN Y ESTATE	0.97%	
2	1	1	MAGOON,JOHN H SR TR	0.97%	

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP BY ACCESSED VALUES, FOR SUB-MARKET, (ZONE 1-2), FOR PITT 400

Totals	Leasehold	Fee Simple	TMK Owner/Lessor	% Totals	Top 5 %
\$ 107,730,800	\$ 82,138,500	\$ 25,592,300	VICTORIA WARD LIMITED	28.06%	54.35%
\$ 54,539,500	\$ 38,533,800	\$ 16,005,700	B P BISHOP ESTATE	14.20%	
\$ 20,354,700	\$ 18,346,200	\$ 2,008,500	HAWAII COMM DEV AUTHORITY	5.30%	
\$ 15,415,400	\$ 15,415,400	\$ -	B&M INVESTMENT INC	4.01%	
\$ 10,647,500	\$ -	\$ 10,647,500	WAIMANU ASSOCIATES	2.77%	
\$ 7,402,800	\$ -	\$ 7,402,800	GASCO INC	1.93%	
\$ 7,342,600	\$ 7,342,600	\$ -	MAGOON,JULIET C TR EST /ETAL	1.91%	
\$ 5,354,200	\$ -	\$ 5,354,200	WATERHOUSE PROPERTIES INC	1.39%	
\$ 4,477,900	\$ 4,477,900	\$ -	CITY & COUNTY OF HONOLULU	1.17%	
\$ 4,384,300	\$ -	\$ 4,384,300	SMK INC	1.14%	
\$ 4,043,100	\$ -	\$ 4,043,100	U OKADA & CO LTD	1.05%	
\$ 4,013,300	\$ 1,495,300	\$ 2,518,000	ING,JOHN Y ESTATE	1.05%	
\$ 3,826,400	\$ -	\$ 3,826,400	ZOBEL,DEE A H TR	1.00%	
\$ 3,824,500	\$ -	\$ 3,824,500	KAM DEVELOPMENT CORP	1.00%	
\$ 3,775,200	\$ 3,775,200	\$ -	HOLLIS,DONALD F JR TR	0.98%	
\$ 3,576,400	\$ -	\$ 3,576,400	SCHUMAN CARRIAGE CO LTD	0.93%	
\$ 3,435,400	\$ -	\$ 3,435,400	HONOLULU SELF STORAGE LLC	0.89%	
\$ 3,059,100	\$ -	\$ 3,059,100	HAWN TRANS & ROCK PROD LTD	0.80%	
\$ 3,045,600	\$ 3,045,600	\$ -	FUJI SAKE BREWING CO LTD	0.79%	
\$ 2,982,100	\$ -	\$ 2,982,100	HAWN SECURITIES/REALTY LTD	0.78%	
\$ 2,899,700	\$ -	\$ 2,899,700	HAWAIIAN HARDWOOD CO LTD	0.76%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP BY ACCESSED
VALUES, FOR SUB-MARKET, (ZONE 1-2), FOR PITT 400

Leasehold	Fee Simple	TMK Owner/Lessor	% Leased	Top 5 %
\$ 82,138,500	\$ 25,592,300	VICTORIA WARD LIMITED	40.91%	80.57%
\$ 38,533,800	\$ 16,005,700	B P BISHOP ESTATE	19.19%	
\$ 18,346,200	\$ 2,008,500	HAWAII COMM DEV AUTHORITY	9.14%	
\$ 15,415,400	\$ -	B&M INVESTMENT INC	7.68%	
\$ 7,342,600	\$ -	MAGOON,JULIET C TR EST /ETAL	3.66%	
\$ 4,477,900	\$ -	CITY & COUNTY OF HONOLULU	2.23%	
\$ 3,775,200	\$ -	HOLLIS,DONALD F JR TR	1.88%	
\$ 3,045,600	\$ -	FUJI SAKE BREWING CO LTD	1.52%	
\$ 2,751,300	\$ -	KAYA T LTD	1.37%	
\$ 2,275,200	\$ -	STATE OF HAWAII	1.13%	
\$ 2,224,500	\$ -	HO,EMMA L TR /ETAL	1.11%	
\$ 1,624,000	\$ -	STAR INVESTMENT COMPANY	0.81%	
\$ 1,495,300	\$ 2,518,000	ING,JOHN Y ESTATE	0.74%	
\$ 1,345,100	\$ -	KAGAWA,MASAO TRUST /ETAL	0.67%	
\$ 1,298,700	\$ 506,100	MAGOON,JOHN H SR TR	0.65%	
\$ 1,216,400	\$ -	HSG & COMM DEV CORP OF HI	0.61%	
\$ 1,117,200	\$ 512,100	HAWN SECURITIES & RLTY LTD	0.56%	
\$ 1,071,700	\$ -	MAR,DAVID Y TRUSTEE	0.53%	
\$ 940,400	\$ -	TAKATA,HYO SUN GDN	0.47%	
\$ 906,800	\$ -	LEONG BROTHERS	0.45%	
\$ 861,900	\$ -	LEVINTHOL,ABRAM TR	0.43%	

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP BY SQUARE FOOTAGE,
FOR SUB-MARKET, (ZONE 1-2,), FOR PITT 400

Totals	Leasehold	Fee Simple	TMK Owner/Lessor	% Totals	Top 5 %
1,435,396	915,251	520,145	VICTORIA WARD LIMITED	31.48%	62.63%
576,512	472,915	103,597	HAWAII COMM DEV AUTHORITY	12.64%	
571,374	382,964	188,410	B P BISHOP ESTATE	12.53%	
186,900	186,900	-	B&M INVESTMENT INC	4.10%	
85,781	-	85,781	GASCO INC	1.88%	
71,441	71,441	-	MAGOON,JULIET C TR EST /ETAL	1.57%	
54,848	-	54,848	WAIMANU ASSOCIATES	1.20%	
51,431	-	51,431	WATERHOUSE PROPERTIES INC	1.13%	
44,046	-	44,046	SMK INC	0.97%	
41,962	13,162	28,800	ING,JOHN Y ESTATE	0.92%	
40,762	40,762	-	STATE OF HAWAII	0.89%	
34,187	-	34,187	HAWN TRANS & ROCK PROD LTD	0.75%	
33,736	-	33,736	KAM DEVELOPMENT CORP	0.74%	
32,000	32,000	-	HOLLIS,DONALD F JR TR	0.70%	
30,000	-	30,000	HAWN SECURITIES/REALTY LTD	0.66%	
30,000	-	30,000	U OKADA & CO LTD	0.66%	
30,000	-	30,000	ZOBEL,DEE A H TR	0.66%	
29,414	-	29,414	HONOLULU SELF STORAGE LLC	0.64%	
29,213	-	29,213	HAWAIIAN HARDWOOD CO LTD	0.64%	
25,266	25,266	-	FUJI SAKE BREWING CO LTD	0.55%	

**BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP BY SQUARE
FOOTAGE, FOR SUB-MARKET, (ZONE 1-2), FOR PITT 400**

Leasehold	Fee Simple	TMK Owner/Lessor	% Leased	Top 5 %
915,251	520,145	VICTORIA WARD LIMITED	38.32%	84.96%
472,915	103,597	HAWAII COMM DEV AUTHORITY	19.80%	
382,964	188,410	B P BISHOP ESTATE	16.03%	
186,900	-	B&M INVESTMENT INC	7.82%	
71,441	-	MAGOON,JULIET C TR EST /ETAL	2.99%	
40,762	-	STATE OF HAWAII	1.71%	
32,000	-	HOLLIS,DONALD F JR TR	1.34%	
25,266	-	FUJI SAKE BREWING CO LTD	1.06%	
23,800	-	KAYA T LTD	1.00%	
20,350	-	HO,EMMA L TR /ETAL	0.85%	
15,276	-	STAR INVESTMENT COMPANY	0.64%	
13,807	-	CITY & COUNTY OF HONOLULU	0.58%	
13,551	4,975	MAGOON,JOHN H SR TR	0.57%	
13,173	-	HSG & COMM DEV CORP OF HI	0.55%	
13,162	28,800	ING,JOHN Y ESTATE	0.55%	
10,000	5,200	HAWN SECURITIES & RLTY LTD	0.42%	
10,000	-	KAGAWA,MASAO TRUST /ETAL	0.42%	
10,000	-	LEONG BROTHERS	0.42%	
10,000	-	TAKATA,HYO SUN GDN	0.42%	
9,914	-	MAR,DAVID Y TRUSTEE	0.42%	
9,888	-	BOSLEY,ROBERT M TR	0.41%	

Zone 1-3 only, for PITT 400

ZONE 1-3 HAS NO INDUSTRIAL AREA PITT 400

Zone 1-4 only, for PITT 400

	FEE PARCELS	LEASEHOLD	Grand Total
Count of Parcels	33	56	89
Total of Assessed Value	32,960,700	64,588,300	97,549,000
Total of TMK Land area	856,419	4,732,303	5,588,722

Percentage of Total Market (Market Share)

	Fee	Leasehold
Parcels	37.1%	62.9%
Assessed Value	33.8%	66.2%
Land Area	15.3%	84.7%
Assessed Value/SqFt	\$ 38.49	\$ 13.65

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP, FOR SUB-MARKET,
(ZONE 1-4), FOR PITT 400

Total	Leasehold	Fee Simple	TMK Owner/Lessor	% Total	Top 5 %
30	29	1	B P BISHOP ESTATE	33.71%	57.30%
10	9	1	CASTLE FAM LTD PARTNERSHIP	11.24%	
5	3	2	FARM FAMILY PARTNERSHIP	5.62%	
3	1	2	H K L CASTLE TR EST ART	3.37%	
3	2	1	HAITSUKA,EDMUND H /ETAL	3.37%	
3	3	-	IIDA,HENRY T /ETAL	3.37%	
3	3	-	ISHIMOTO,MABEL M FAMILY TR	3.37%	
2	2	-	BALDWIN,MICHAEL C TR /ETAL	2.25%	
2	2	-	CASTLE,ALICE H TRUST	2.25%	
2	-	2	LURIA,MARK	2.25%	
2	-	2	MIDWEEK PRINTING INC	2.25%	
2	-	2	T IIDA CONTRACTING LTD	2.25%	
2	-	2	KALAMA LAND CO LTD	2.25%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP, FOR SUB-
MARKET, (ZONE 1-4), FOR PITT 400

Leasehold	Fee Simple	TMK Owner/Lessor	% Leased	Top 5 %
29	1	B P BISHOP ESTATE	51.79%	83.93%
9	1	CASTLE FAM LTD PARTNERSHIP	16.07%	
3	2	FARM FAMILY PARTNERSHIP	5.36%	
3	-	IIDA,HENRY T /ETAL	5.36%	
3	-	ISHIMOTO,MABEL M FAMILY TR	5.36%	
2	1	HAITSUKA,EDMUND H /ETAL	3.57%	
2	-	BALDWIN,MICHAEL C TR /ETAL	3.57%	
2	-	CASTLE,ALICE H TRUST	3.57%	
1	2	H K L CASTLE TR EST ART	1.79%	
1	-	CITY & COUNTY OF HONOLULU	1.79%	
1	-	YAMASHIRO,AARON K /ETAL	1.79%	

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP BY ACCESSED VALUES,
FOR SUB-MARKET, (ZONE 1-4), FOR PITT 400

Total	Leasehold	Fee Simple	TMK Owner/Lessor	% Total	Top 5 %
\$ 30,676,300	\$ 29,777,600	\$ 898,700	B P BISHOP ESTATE	31.45%	57.74%
\$ 8,649,200	\$ 7,028,100	\$ 1,621,100	CASTLE FAM LTD PARTNERSHIP	8.87%	
\$ 6,032,500	\$ 3,712,900	\$ 2,319,600	FARM FAMILY PARTNERSHIP	6.18%	
\$ 5,682,700	\$ 5,682,700	\$ -	BALDWIN,MICHAEL C TR /ETAL	5.83%	
\$ 5,285,300	\$ 5,285,300	\$ -	ISHIMOTO,MABEL M FAMILY TR	5.42%	
\$ 4,980,800	\$ 3,979,900	\$ 1,000,900	HAITSUKA,EDMUND H /ETAL	5.11%	
\$ 3,923,000	\$ -	\$ 3,923,000	LURIA,MARK	4.02%	
\$ 3,654,800	\$ -	\$ 3,654,800	KAISER FDN HEALTH PLAN INC	3.75%	
\$ 3,192,900	\$ -	\$ 3,192,900	EY YAMASHIRO LTD PARTNERSHP	3.27%	
\$ 2,967,800	\$ 2,967,800	\$ -	YAMASHIRO,AARON K /ETAL	3.04%	
\$ 2,841,100	\$ -	\$ 2,841,100	MIDWEEK PRINTING INC	2.91%	
\$ 2,324,400	\$ 2,324,400	\$ -	CITY & COUNTY OF HONOLULU	2.38%	
\$ 2,256,800	\$ -	\$ 2,256,800	H K L CASTLE FOUNDATION	2.31%	
\$ 2,157,200	\$ 689,900	\$ 1,467,300	H K L CASTLE TR EST ART	2.21%	
\$ 2,076,600	\$ 2,076,600	\$ -	IIDA,HENRY T /ETAL	2.13%	
\$ 1,824,400	\$ -	\$ 1,824,400	WONG,THOMAS L/CHYOKO /ETAL	1.87%	
\$ 1,468,500	\$ -	\$ 1,468,500	KALAMA LAND CO LTD	1.51%	
\$ 1,063,100	\$ 1,063,100	\$ -	CASTLE,ALICE H TRUST	1.09%	
\$ 714,700	\$ -	\$ 714,700	CHUN,ROLAND K C/JANIS Y C	0.73%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP BY ACCESSED
VALUES, FOR SUB-MARKET, (ZONE 1-4), FOR PITT 400

Leasehold	Fee Simple	TMK Owner/Lessor	% Leased	Top 5 %
\$ 29,777,600	\$ 898,700	B P BISHOP ESTATE	46.10%	80.13%
\$ 7,028,100	\$ 1,621,100	CASTLE FAM LTD PARTNERSHIP	10.88%	
\$ 5,682,700	\$ -	BALDWIN,MICHAEL C TR /ETAL	8.80%	
\$ 5,285,300	\$ -	ISHIMOTO,MABEL M FAMILY TR	8.18%	
\$ 3,979,900	\$ 1,000,900	HAITSUKA,EDMUND H /ETAL	6.16%	
\$ 3,712,900	\$ 2,319,600	FARM FAMILY PARTNERSHIP	5.75%	
\$ 2,967,800	\$ -	YAMASHIRO,AARON K /ETAL	4.59%	
\$ 2,324,400	\$ -	CITY & COUNTY OF HONOLULU	3.60%	
\$ 2,076,600	\$ -	IIDA,HENRY T /ETAL	3.22%	
\$ 1,063,100	\$ -	CASTLE,ALICE H TRUST	1.65%	
\$ 689,900	\$ 1,467,300	H K L CASTLE TR EST ART	1.07%	

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP BY SQUARE FOOTAGE,
FOR SUB-MARKET, (ZONE 1-4), FOR PITT 400

Total	Leasehold	Fee Simple	TMK Owner/Lessor	% Total	Top 5 %l
2,458,090	2,458,090	-	CITY & COUNTY OF HONOLULU	43.98%	81.34%
969,776	969,776	-	BALDWIN, MICHAEL C TR /ETAL	17.35%	
763,219	742,113	21,106	B P BISHOP ESTATE	13.66%	
188,431	105,269	83,162	FARM FAMILY PARTNERSHIP	3.37%	
166,160	-	166,160	EY YAMASHIRO LTD PARTNERSHP	2.97%	
150,111	118,824	31,287	CASTLE FAM LTD PARTNERSHIP	2.69%	
114,668	-	114,668	KAISER FDN HEALTH PLAN INC	2.05%	
109,639	109,639	-	ISHIMOTO, MABEL M FAMILY TR	1.96%	
107,017	86,812	20,205	HAITSUKA, EDMUND H /ETAL	1.91%	
86,460	-	86,460	LURIA, MARK	1.55%	
71,954	71,954	-	YAMASHIRO, AARON K /ETAL	1.29%	
49,585	-	49,585	MIDWEEK PRINTING INC	0.89%	
45,257	15,000	30,257	H K L CASTLE TR EST ART	0.81%	
45,000	-	45,000	H K L CASTLE FOUNDATION	0.81%	
36,001	36,001	-	IIDA, HENRY T /ETAL	0.64%	
34,600	-	34,600	WONG, THOMAS L/CHIYOKO /ETAL	0.62%	
25,965	-	25,965	KALAMA LAND CO LTD	0.46%	
18,825	18,825	-	CASTLE, ALICE H TRUST	0.34%	
18,000	-	18,000	T IIDA CONTRACTING LTD	0.32%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP BY SQUARE
FOOTAGE, FOR SUB-MARKET, (ZONE 1-4), FOR PITT 400

Leasehold	Fee Simple	TMK Owner/Lessor	% Leased	Top 5 %
2,458,090	-	CITY & COUNTY OF HONOLULU	51.94%	92.95%
969,776	-	BALDWIN, MICHAEL C TR /ETAL	20.49%	
742,113	21,106	B P BISHOP ESTATE	15.68%	
118,824	31,287	CASTLE FAM LTD PARTNERSHIP	2.51%	
109,639	-	ISHIMOTO, MABEL M FAMILY TR	2.32%	
105,269	83,162	FARM FAMILY PARTNERSHIP	2.22%	
86,812	20,205	HAITSUKA, EDMUND H /ETAL	1.83%	
71,954	-	YAMASHIRO, AARON K /ETAL	1.52%	
36,001	-	IIDA, HENRY T /ETAL	0.76%	
18,825	-	CASTLE, ALICE H TRUST	0.40%	
15,000	30,257	H K L CASTLE TR EST ART	0.32%	

Zone 1-9 only, for PITT 400

	FEE PARCELS	LEASEHOLD	Grand Total	
Count of Parcels		377	168	545
Total of Assessed Value	757,952,100	256,934,600	1,014,886,700	
Total of TMK Land area	51,109,278	71,516,595	122,625,873	

Percentage of Total Market (Market Share)

	Fee	Leasehold
Parcels	69.2%	30.8%
Accessed Value	74.7%	25.3%
Land Area	41.7%	58.3%
Accessed Value/SqFt	\$ 14.83	\$ 3.59

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP, FOR SUB-MARKET,
(ZONE 1-4), FOR PITT 400

Total	Leasehold	Fee Simple	TMK Owner/Lessor	% Total	Top 5 %
126	126	-	JAMES CAMPBELL TRUST EST	23.20%	37.80%
37	1	36	CIRI LAND DEV CO	6.81%	
21	-	21	GENTRY PROPERTIES	3.87%	
11	-	11	A & B PROPERTIES INC	2.03%	
11	11	-	STATE OF HAWAII	2.03%	
7	-	7	GENTRY,THOMAS H TR	1.29%	
6	-	6	GPP LLC	1.10%	
6	1	5	PACIFIC WAREHOUSE INC	1.10%	
4	-	4	GENTRY PACIFIC LIMITED	0.74%	
4	-	4	GRACE PACIFIC CORP	0.74%	
4	-	4	PTW INC	0.74%	
4	1	3	SD CONSULTING LLC /ETAL	0.74%	
3	-	3	QUEEN EMMA FOUNDATION	0.55%	
3	-	3	TAKI,HIROJI TRUST /ETAL	0.55%	
3	-	3	TESORO HAWAII CORP	0.55%	
3	-	3	WALKER MOODY CONSTR CO LTD	0.55%	
3	-	3	ZIPPY'S INC	0.55%	
3	-	3	DMLM LLC	0.55%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP, FOR SUB-MARKET, (ZONE 1-9), FOR PITT 400

Leasehold	TMK Owner/Lessor	% Leased	Top 5 %
126	JAMES CAMPBELL TRUST EST	75.90%	84.94%
11	STATE OF HAWAII	6.63%	
2	GT ASSOCIATES	1.20%	
1	CIRI LAND DEV CO	0.60%	
1	PACIFIC WAREHOUSE INC	0.60%	
1	SD CONSULTING LLC /ETAL	0.60%	
1	AE VENTURES	0.60%	
1	HOW,CLIFFORD K C /ETAL	0.60%	
1	SERIKAKU,JAMES T/BEATRICE T	0.60%	
1	SSS VENTURES INC	0.60%	
1	B P BISHOP ESTATE	0.60%	
1	DAMON,SAMUEL M TR EST	0.60%	
1	TERUYA BROTHERS LTD	0.60%	
1	ART SOURCE INC	0.60%	
1	CAMPBELL WATUMULL LLC	0.60%	
1	CONROY,HAROLD W TR D /ETAL	0.60%	

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP BY ACCESSED VALUES, FOR SUB-MARKET, (ZONE 1-9), FOR PITT 400

Totals	Leasehold	Fee Simple	TMK Owner/Lessor	% Totals	Top 5 %
\$193,823,700	\$193,823,700	\$0	JAMES CAMPBELL TRUST EST	19.10%	36.66%
\$73,612,200	\$0	\$73,612,200	CHEVRON U S A INC	7.25%	
\$51,520,600	\$0	\$51,520,600	TESORO HAWAII CORP	5.08%	
\$28,459,700	\$0	\$28,459,700	COSTCO WHOLESALE CORP	2.80%	
\$24,604,500	\$0	\$24,604,500	GENTRY PROPERTIES	2.42%	
\$21,081,100	\$0	\$21,081,100	BANK OF HAWAII	2.08%	
\$19,128,900	\$0	\$19,128,900	GPP LLC	1.88%	
\$18,059,300	\$10,553,800	\$7,505,500	PACIFIC WAREHOUSE INC	1.78%	
\$17,273,900	\$0	\$17,273,900	ZIPPY'S INC	1.70%	
\$16,530,600	\$0	\$16,530,600	GENTRY,THOMAS H TR	1.63%	
\$16,046,700	\$331,400	\$15,715,300	CIRI LAND DEV CO	1.58%	
\$15,201,800	\$0	\$15,201,800	PARADISE BEVERAGES INC	1.50%	
\$12,922,400	\$0	\$12,922,400	HRT LTD	1.27%	
\$11,314,500	\$0	\$11,314,500	GENTRY PACIFIC LIMITED	1.11%	
\$11,290,900	\$0	\$11,290,900	A & B PROPERTIES INC	1.11%	
\$11,219,100	\$0	\$11,219,100	LIBERTY HOUSE INC	1.11%	
\$10,975,100	\$0	\$10,975,100	HAWAIIAN CEMENT	1.08%	
\$10,633,100	\$0	\$10,633,100	BETTER BRANDS LTD	1.05%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP BY ACCESSED
VALUES, FOR SUB-MARKET, (ZONE 1-9), FOR PITT 400

Leasehold	TMK Owner/Lessor	% Leased	Top 5 %
\$193,823,700	JAMES CAMPBELL TRUST EST	75.44%	88.21%
\$10,553,800	PACIFIC WAREHOUSE INC	4.11%	
\$10,060,700	G2000 PROPERTY CORP	3.92%	
\$8,712,800	CAMPBELL WATUMULL LLC	3.39%	
\$3,995,300	STATE OF HAWAII	1.55%	
\$2,152,700	ART SOURCE INC	0.84%	
\$2,077,500	W&J HIGDON FAM LTD PRTRNSHP	0.81%	
\$1,873,900	DONG, KYLE E TR	0.73%	
\$1,814,300	DUMAS WAIPIO PARTNERS	0.71%	
\$1,718,000	JADSL CORP	0.67%	
\$1,657,900	KING'S HAWN BAKERY WEST INC	0.65%	
\$1,643,500	AE VENTURES	0.64%	
\$1,643,000	IAN'S AUTO BODY & PAINT INC	0.64%	
\$1,611,900	DAMON, SAMUEL M TR EST	0.63%	
\$1,374,700	TERUYA BROTHERS LTD	0.54%	
\$1,261,700	NAKASHIMA, IAN R/SHAY'ANNE S	0.49%	

BREAKDOWN OF TOTAL PROPERTY OWNERSHIP BY SQUARE FOOTAGE,
FOR SUB-MARKET, (ZONE 1-2,), FOR PITT 400

Totals	TMK Owner/Lessor	% Totals	Top 5 %
69,681,192	JAMES CAMPBELL TRUST EST	56.82%	76.99%
11,240,047	CHEVRON U S A INC	9.17%	
5,717,771	TESORO HAWAII CORP	4.66%	
5,384,321	HRT LTD	4.39%	
2,391,660	CIRI LAND DEV CO	1.95%	
1,529,435	BANK OF HAWAII	1.25%	
1,326,344	A & B PROPERTIES INC	1.08%	
1,294,560	HAWAIIAN CEMENT	1.06%	
1,182,653	ROADS LLC	0.96%	
803,246	COSTCO WHOLESALE CORP	0.66%	
729,630	AMERON INTERNATIONAL CORP	0.60%	
701,403	QUEEN EMMA FOUNDATION	0.57%	
691,707	AMFAC PROPERTY DEV CORP	0.56%	
647,389	HAWAIIAN ELECTRIC CO INC	0.53%	
577,636	PACIFIC WAREHOUSE INC	0.47%	
527,250	MUTUAL WELDING COMPANY LTD	0.43%	
525,642	GENTRY PROPERTIES	0.43%	
487,349	BALL METAL BEV CONTAINER	0.40%	
405,100	GENTRY, THOMAS H TR	0.33%	
397,354	CAMPBELL WATUMULL LLC	0.32%	

BREAKDOWN OF LEASEHOLD PROPERTY OWNERSHIP BY SQUARE
FOOTAGE, FOR SUB-MARKET, (ZONE 1-9), FOR PITT 400

Leasehold	TMK Owner/Lessor	% Leased	Top 5 %
69,681,192	JAMES CAMPBELL TRUST EST	89.29%	95.07%
397,354	CAMPBELL WATUMULL LLC	2.32%	
304,920	PACIFIC WAREHOUSE INC	1.78%	
167,270	G2000 PROPERTY CORP	0.98%	
119,939	STATE OF HAWAII	0.70%	
103,455	DONG,KYLE E TR	0.60%	
95,095	ART SOURCE INC	0.55%	
49,098	YEE,WALLACE P TR /ETAL	0.29%	
46,824	JADSL CORP	0.27%	
45,000	TERUYA BROTHERS LTD	0.26%	
45,000	CONROY,HAROLD W TR D /ETAL	0.26%	
45,000	W&J HIGDON FAM LTD PRTNRSH	0.26%	
43,529	DAMON,SAMUEL M TR EST	0.25%	
42,461	AE VENTURES	0.25%	
41,317	PEARL CITY COMMUNITY CHURCH	0.24%	
39,800	CIRI LAND DEV CO	0.23%	
36,676	B P BISHOP ESTATE	0.21%	
25,000	KING'S HAWN BAKERY WEST INC	0.15%	
23,490	SERIKAKU,JAMES T TR /ETAL	0.14%	

Appendix N



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ECONOMIC IMPACT REPORT ON COMMERCIAL AND INDUSTRIAL LEASE RENT ISSUES

October 2003

Prepared for:

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EXECUTIVE SUMMARY

This report responds to the claims that led to Senate Concurrent Resolution 89 of the 22nd Legislature, State of Hawaii. The resolution testifies to a concern that high ground rents on commercial properties lead to high lease rents and to high business costs in Hawaii, and hence harm the economy.

Are Hawaii businesses in trouble, and hence cutting jobs and capital expenditures?

The 1990s involved little growth, and much pain, for businesses in Hawaii. Conditions are improving. Business confidence is much better now than five years ago. While job growth is still slow, wages have been increasing.

SMS analyzed the basic assumption that lease rents are a primary motor of economic growth in Hawaii. The data show otherwise. Tourism indicators tell us a lot about the economy; lease rents show little correlation with economic growth or decline.

Are Hawaii businesses failing at high rates?

No. Bankruptcy filings are fewer from year to year.

Have lease rents risen at high rates?

Lease rents have not yet returned to 1991 levels. More importantly, they are not yet high enough to justify new investment in commercial or industrial space. As a result, industrial rents will continue to climb, until they reach a level that will justify creating new space.

Moreover, the rate at which lease rents have risen over the long term is modest compared to several other costs of doing business, such as health care and wages. Lease rents have risen more slowly than the Consumer Price Index, the standard gauge of inflation. Lease rents are hence not an important cause of increased cost of doing business in Hawaii.

Have lease rents reached or exceeded levels supportable by the use of their properties?

If lease rents were not supportable, leased spaces would be empty. They are not. Industrial spaces have very high occupancy; office and retail spaces are also largely occupied. (Honolulu office occupancy is not as high as many building operators would like, but better than in many US Mainland cities.)

How would strategies to change the impact of lease rents affect business in Hawaii?

It would be very hard to devise a legislative strategy to approach the problem – if it is a problem – without having very general impacts, especially on investment. First, limits on leasehold agreements would make this arrangement less attractive to investors, lowering the likelihood that new commercial and industrial space will be developed. Second, if the State is willing to change the terms of long-term commercial relations between landowners and tenant businesses, it is clearly signaling that investors cannot enter into long-term contracts with certainty that they will be upheld. This will have a chilling effect on investment.

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INTRODUCTION

THE LEASE RENT ISSUE

Senate Concurrent Resolution No. 89 of the 22nd Legislature, State of Hawaii requests a study of real property leases in response to claims that land values became “artificially high” between 1985 and 1990, and lease rents renegotiated during or after that time impose burdens on lessees that can lead to foreclosure or business failure. The report, from the Legislative Reference Bureau, is to include findings and recommendations, including any proposed legislation.

Similarly, in 1993, a task force was formed to examine the problems of lessees. The task force reported that some lessees, renegotiating leases that had been set for 20 or 30 years, “found themselves facing increases in excess of 200%.” SCR 89 notes that “ten years have passed and many problems for lessees still remain.”

The claims include several assumptions and statements about historical or current facts:

- Claim 1: Hawaii businesses are suffering, and as a consequence are cutting employment and capital expenditures;
- Claim 2: Hawaii businesses are failing at high rates;
- Claim 3: Ground rents have risen at disproportionately high rates, leading lessees to pay an exorbitant share of their revenues for lease rents; and
- Claim 4: Lease rents are at levels that can't be supported by the “economic uses” of the properties.

Any legislation to address the issue would presumably respond to the claim that lease rents have had extremely negative impacts not just on particular firms but on the economy as a whole, and would presumably propose strategies to mitigate or avoid such impacts.

SCOPE OF THIS REPORT

This report provides information to help decision makers assess the claims and assumptions presented above. It provides historical data relevant to those claims. On the basis of the data, a framework is developed for analysis of strategies to mitigate or avoid negative impacts of lease rent increases.

The Legislative Reference Bureau is gathering information from concerned parties about their own leases and firms. Complementing that focus, this study emphasizes the claims that general impacts on the economy have followed from particular lease relationships.

METHODS AND CONCEPTUAL ISSUES

This report is mainly based on publicly available data. SMS's effort has consisted of finding and compiling data in various reports, developing unified time series when information is reported in different ways in different years, tabulating and analyzing the results.¹ SMS draws on Oahu data from Colliers Consulting, a division of Colliers Monroe Friedlander, Inc., which has kept close track of commercial and industrial real estate trends for many years.

Some data series are reliable or indexed over many decades; others are shorter because of changing definitions, indices, or availability. Since the report is concerned with changes since 1991, all data series run from at least 1990, and series from 1980 to the present are preferred. Data series are reported in terms of annual totals or averages, in order to fix attention on year-to-year change in the economy.

The report deals mainly with properties classified as commercial and industrial, for several reasons:

- The initial concern stimulating SCR 89 had to do with such properties.
- While some attention is paid here to resort properties (since they are important properties for income generation and investment), that classification covers a wide range of products (including hotels, condominiums, vacation homes) that cannot be discussed in detail here. The classification "Hotel/Resort" covers a mix of income-generating and residential properties
- Residential leasehold has been the subject of extensive discussions, analysis and legislation. Those discussions and laws are outside the scope of this report. Most residential lessees are not in business as users of their homes. Most do not rent out space on the land they lease.

In this report, attention focuses on space rentals, not ground rentals, for two reasons: the data are available and the argument being examined is that the cost of using space for many businesses – not just the cost of land – is a problem.

SMS has relied on sources deemed reliable, but not guaranteed to be accurate. Property valuations are taken from real property records (from materials published by the City and County of Honolulu, and from the on-line current database maintained by Hawaii Information Services, Inc.)

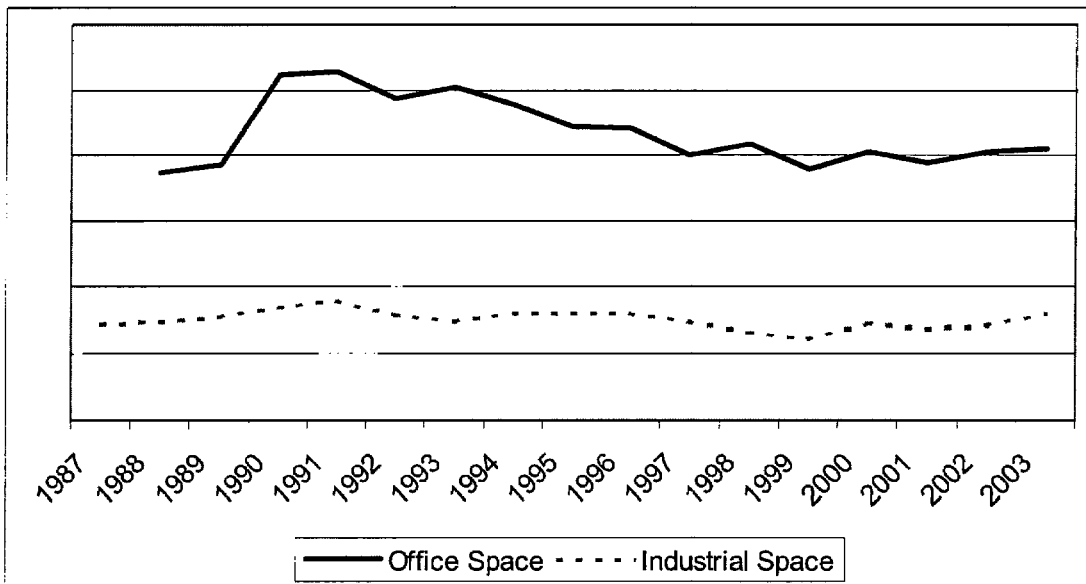
¹ We wish to thank the staff of the Business Library, DBEDT, for their valuable help in finding sources for this report.

HISTORICAL DATA

LEASE RENTS

In order to affect the economy, increases in ground rents should translate into increases in lease rents, affecting large and small businesses. This has not occurred. Exhibit 1 shows that lease rents for both industrial and office space declined during the 1990s. Industrial lease rents are now increasing to levels close to those seen around 1990. If inflation is factored out, the 2002 lease rents were worth only 60% to 65% of the 1990 figures, in constant dollars. (Inflation is estimated here using the Consumer Price Index for Honolulu, which has increased by 33% since 1990.)

Exhibit 1: ANNUAL AVERAGE GROSS LEASE RENTS, OAHU, 1987 – 2003

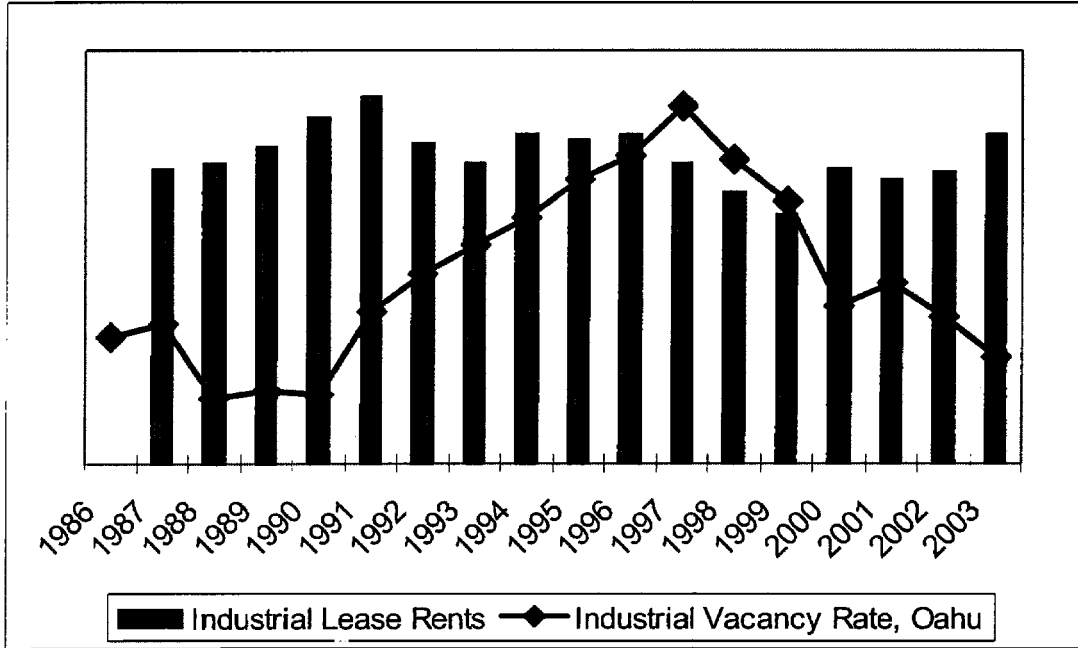


NOTE: At the request of Colliers Consulting, precise lease rent average amounts and vacancy rates are not displayed in this report. Rents are annual averages through 2002, and second quarter 2003 average, in current dollars.

SOURCE: Colliers Consulting, a division of Colliers Monroe Friedlander, Inc.

The recent increase in industrial lease rents is far from surprising, since demand for industrial space is strong. Vacancy rates have fallen to very low levels, as shown in Exhibit 2.

Exhibit 2: INDUSTRIAL LEASE RENTS AND VACANCY RATES, 1986-2003



The above exhibits show major trends that also affect Neighbor Island leases and retail leases: the slowdown of the 1990s translated into lower revenues and lower rents. The retail sector has been affected by the introduction of the “big box” stores to all the islands and by renovation and expansion of visitor retail inventory, so it has seen considerable expansion. In the industrial sector, demand for space has been strong, but, for many landowners, lease rents have not justified expansion (For discussion of the need to double gross rents in order to justify new investment in industrial property, see Coldwell Banker Commercial Real Estate Group of Hawaii, Inc. 1997.)

SMS estimated the size of the leasehold inventory from real property records. Exhibit 3 combines summary data published by the City and County of Honolulu for all the counties of Hawaii with data compiled from a parcel-by-parcel sort of the records to isolate leasehold parcels in the land use classes of interest for this report. It shows that leasehold property in the three categories listed constitutes about 10% of all Hawaii real estate by value, and is assessed about 16% of real property taxes. Within the listed categories, leasehold parcels amount to 39% of total value. Leasehold is, then, an important part of Hawaii’s non-residential land.

Exhibit 3: LEASEHOLD COMMERCIAL LAND IN HAWAII, 2003

2003-2004 – Values and Taxes in	All Parcels			Leasehold Parcels		
	Value for Taxation			Valuation		
	Land	Improvements	Taxes	Land	Improvements	Estimated Taxes
STATEWIDE						
Commercial	\$6,068,663	\$5,502,874	\$116,995	\$2,450,295	\$2,574,246	\$46,926
Industrial	\$3,633,565	\$2,317,892	\$58,786	\$1,674,066	\$1,120,032	\$27,588
Hotel/Resort	\$4,594,135	\$7,661,873	\$114,727	\$1,458,009	\$2,347,750	\$36,791
Subtotal	\$14,296,363	\$15,482,639	\$290,508	\$5,582,370	\$6,042,028	\$111,305
Total	\$67,260,413	\$51,993,802	\$705,185			

NOTES: Value for “all parcels” is total net value estimated for taxation purposes by assessors (in Honolulu, 2003). Value for leasehold parcels is the sum of values listed in real property tax records (accessed through Hawaii Information Service, Inc.) for parcels with leasehold tenure. For the latter, parcels were sorted by PITT code.

BROAD ECONOMIC TRENDS

For over a decade, Hawaii’s policy-makers have sought ways to strengthen and grow the economy. Many steps have been considered to increase prosperity, including tax incentives for investors, waiving taxes for airlines, rent reductions for the State’s lessees at the airports, simplification of government rules and procedures, targeted investment of state funds, loans and other forms of support for key businesses and start-ups.² Given widespread concern to protect the economy, the idea that lease arrangements may cause economic problems will get a generous hearing.

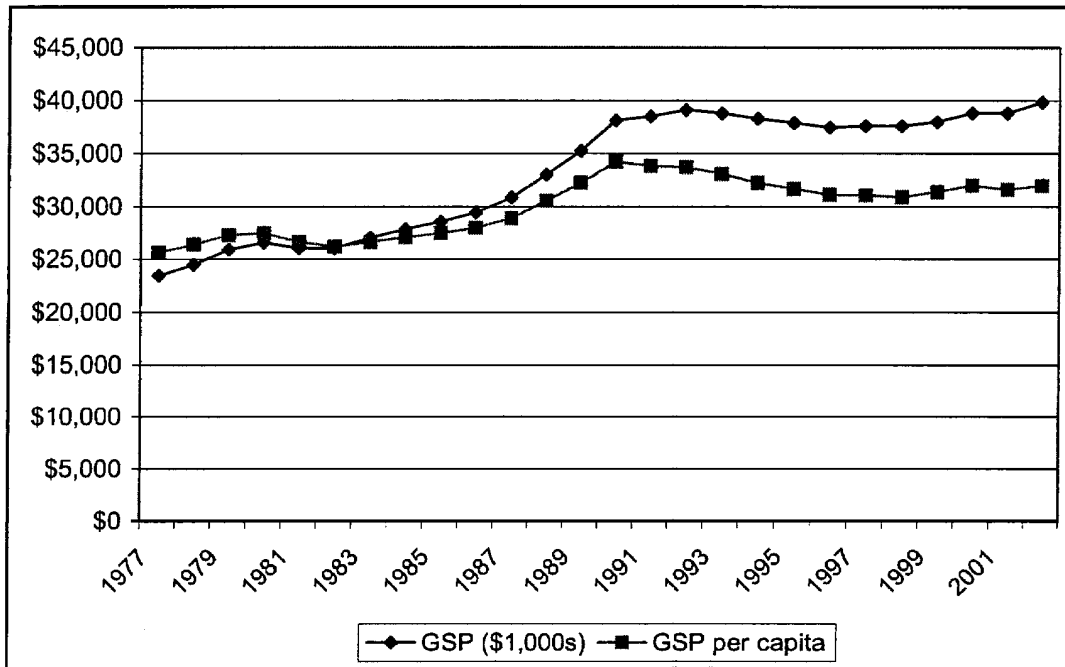
To support the claim, those who would change those arrangements should show, not just assert, that lease rents are a problem and that they affect the wider economy. If lease rents affect employment and investment, and lead to business failures, there might be some impact on employment, investment, and bankruptcies. No such impact is obvious, and alternative explanations are stronger.

Currently, the economic situation is much better than in recent years. The economy has been slowly growing since the late 1990s. This has translated into higher wages for Hawaii’s workforce. Wages have recently been growing at rates well above inflation, as shown in Exhibit 5. (Now that island policemen and Honolulu bus drivers have negotiated contracts with wage increases, other public worker unions will surely follow.)

Hawaii’s unemployment rate has been well below the US average. Statewide, on Oahu and on Maui, the rate is at or near the 4% level many economists consider “full employment.” However, the number of jobs has not grown appreciably. Hawaii is seeing a recovery without significant job creation, much like the US as a whole. (Current official forecasts are for jobs to grow by about 2% over the year 2003, and only 1.3% in 2004 [DBEDT, 2003c].) And, as Exhibit 4 indicated, the GSP per capita, considered in constant dollars, has not returned to the level seen in 1991

² See Grandy (2002) for more discussion.

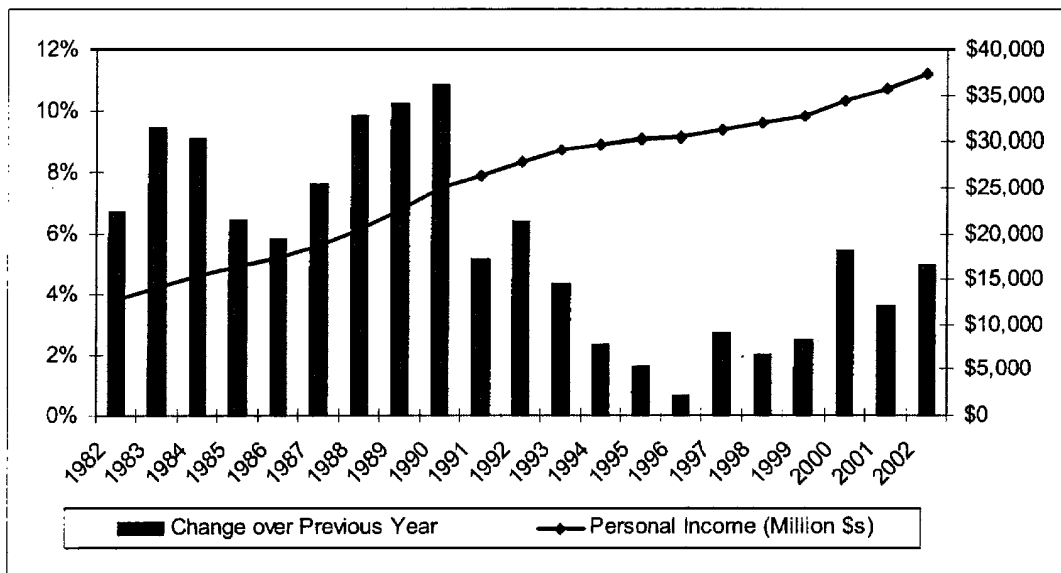
Exhibit 4: HAWAII GROSS STATE PRODUCT, 1977- 2002



NOTE: Both series are shown as constant 1996 dollars, controlling for inflation.

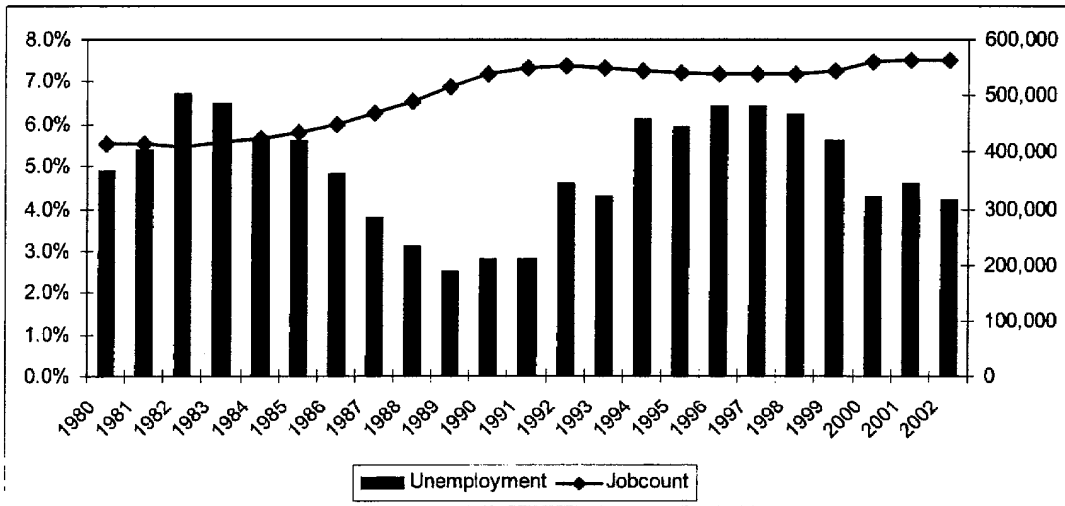
SOURCE: DBEDT, 2003a, 2003b.

Exhibit 5: PERSONAL INCOME GROWTH, 1982-2002



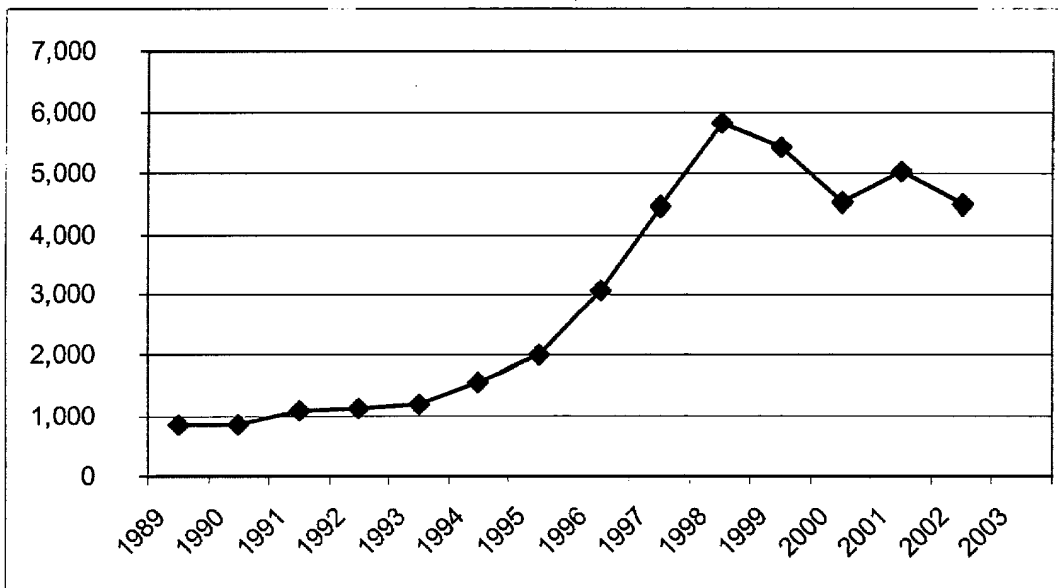
SOURCE: DBEDT, 2003b. Dollar figures are in current dollars, not constant dollars.

Exhibit 6: UNEMPLOYMENT RATE AND JOBCOUNT, 1980-2002



All agree that Hawaii’s economy failed to grow in the 1990s, making residents and local firms face difficult challenges and choices. In difficult times, bankruptcies rose (as shown in Exhibit 7). The number of filings has declined since 1998, and is still declining (Segal, 2003).

Exhibit 7: HAWAII BANKRUPTCY FILINGS, 1989-2002



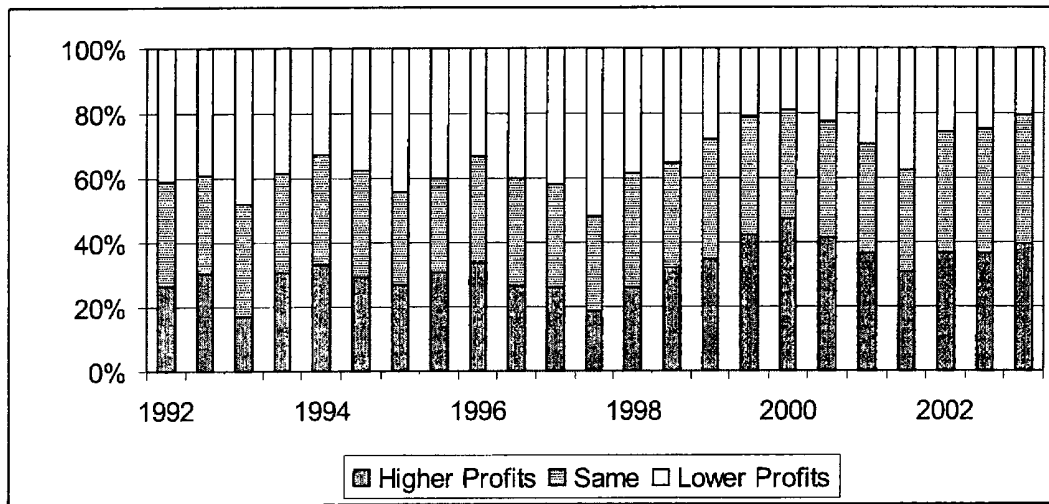
Hawaii’s bankruptcy rate is low in comparison to the US as a whole. In 2002, one bankruptcy was filed in Hawaii for every 105.4 households. The national average was 77.2 households per filing. Of the 51 states and District of Columbia, Hawaii ranked 17th,

i.e., 34 states had fewer households per filing (or, more filings per 1,000 households) than Hawaii (American Bankruptcy Institute, using US Courts and 2000 US Census data, <http://www.abiworld.org/stats/householdrank.html>.)

Business filings are a small part of bankruptcy filings, and they have not increased at the rate seen for personal bankruptcy. In Hawaii, business filings have decreased in number since 1998.³ Hawaii's most prominent local bankruptcies – an airline and a cemetery – have little or nothing to do with land values, much less lease rents.

Moreover, business confidence is rising in Hawaii. The Bank of Hawaii fields a semiannual survey of business expectations to a large sample of Hawaii businesses. Exhibit 8 shows responses from July 1992 through August 2003 to the question, "In your business or company, what are the prospects in the next 12 months for profits?"

Exhibit 8: BUSINESS EXPECTATIONS OF PROFITABILITY, 1992-2003



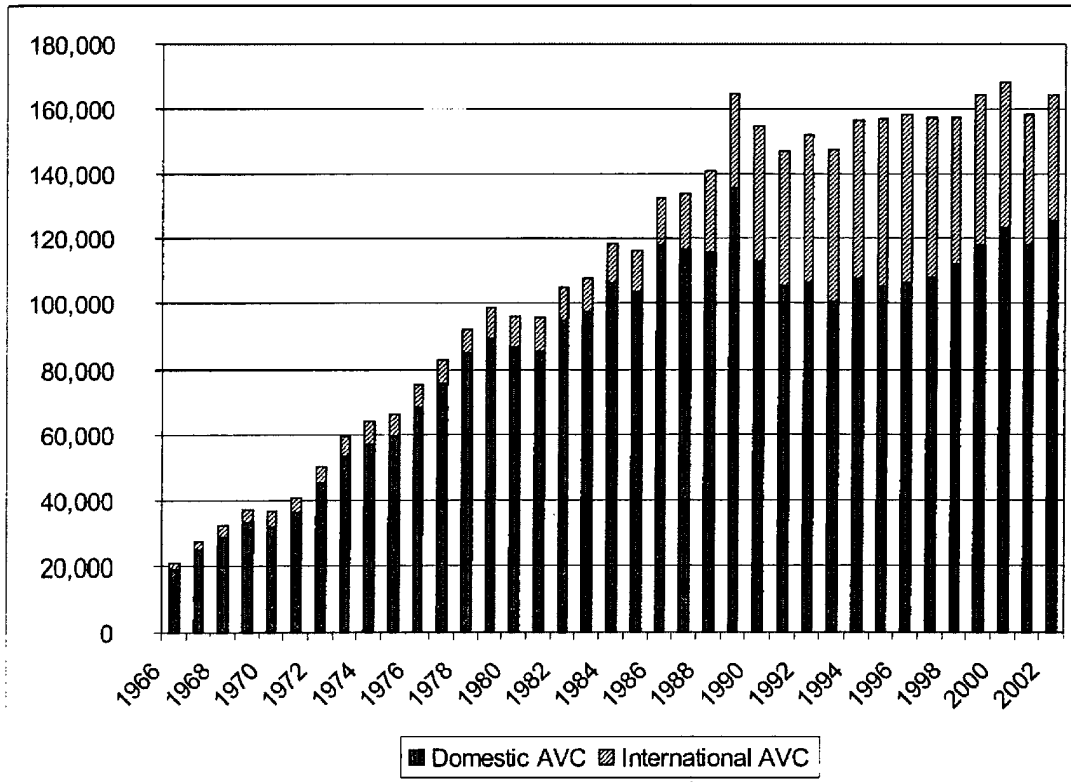
SOURCE: Bank of Hawaii (<http://www.boh.com>).

Only once during the survey period, in early 1998, did a majority of businessmen expect that their profits would decline in the coming year. Confidence improved by 2000, and is now at about the same level as in 2000, despite the September 11 crisis and the uncertainty associated with Afghan and Iraqi military commitments.

³ The association between hard economic times and bankruptcy is complex. If hard times meant troubled businesses that went bankrupt, driving owners, employees and creditors bankrupt, then the rate of business bankruptcies would grow as fast as personal bankruptcies. This has not happened in Hawaii or the US as a whole (DBEDT, 1997). Instead, personal bankruptcies have risen sharply since the mid-1980s, but not business bankruptcies. Credit card and mortgage debt have been identified as major contributing factors. Hawaii's employer-sponsored health care system has been credited with lowering the rate of bankruptcy, since personal bankruptcy elsewhere is often triggered when consumers are unable to pay emergency medical bills (J. Guben, in Segal [2003].)

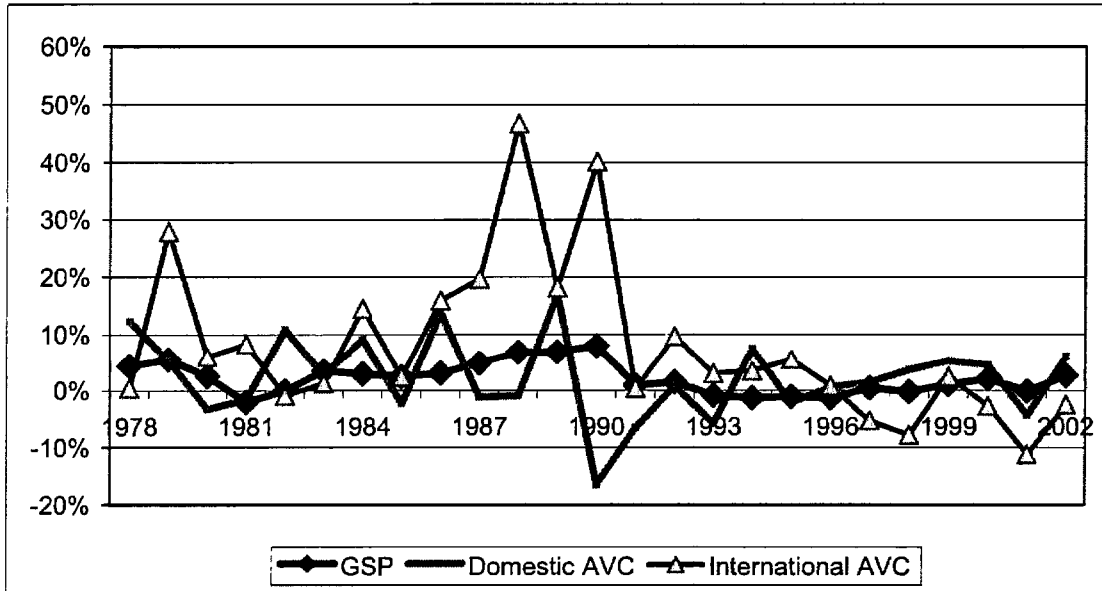
Other sources for Hawaii's problems in the 1990s are well known. Tourism faltered and visitor spending patterns changed considerably. Over a longer period (1987-2002), the correlation between annual changes in Gross State Product and International Average Visitor Count (useful as an indicator of visitor spending) is quite strong (0.819). In the last few years, domestic tourism has returned to play a crucial role in visitor industry growth, so GSP growth is more closely related to total visitor counts, rather than international ones.

Exhibit 9: AVERAGE VISITOR COUNT, STATEWIDE, 1966 TO 2002



SOURCES: DBEDT 2003a, 2003d.

Exhibit 10: RATE OF CHANGE, GROSS STATE PRODUCT AND ANNUAL AVERAGE VISITOR COUNTS



SOURCE: DBEDT, 2003a, 2003b.

If the same analysis is conducted for the lease rent data, the resulting correlation coefficient (0.337 for data between 1987 and 2002) is much weaker – and the same as the correlation between economic growth and change in inflation. This suggests that industrial lease rents have had little on the overall direction of the economy.

LEASE RENTS AS A COST OF DOING BUSINESS

In Hawaii, people are accustomed to thinking of land as precious, and hence land costs as high. Compared to other US areas, the cost of industrial space is currently fairly high, while office space is moderately priced. That makes sense in terms of supply and demand, since there is much more land available for industrial uses on the US Mainland, while the last decade has seen the area used for office space expand far beyond the traditional Central Business District of Honolulu.

In historical terms, lease rents hardly seem a major component in the increasing cost of doing business. Exhibit 11 brings together information on historical price changes of several factors involved in doing business:

Indices: These are calculated by government agencies, and provide general information about changing prices. The Consumer Price Index for Honolulu is the generally accepted measure of inflation in Hawaii. It has been increasing at a higher rate than lease rents. The other measures included show that construction costs have also been rising, while national US manufacturing costs – even for paper, that office staple – have increased more slowly than the Hawaii indices.

Exhibit 11: HISTORICAL INCREASES IN COST OF DOING BUSINESS IN HAWAII

	Average Annual Increase	Period
Indices		All series 1987 to 2002 except:
Consumer Price Index [CPI (U)] Honolulu	3.0%	
Construction Cost Index, Honolulu, Buildings	3.7%	
Producer Price Index, Manufacturing, US	1.9%	
Producer Price Index, Paper US	1.8%	
Labor and Fringe		
Average Wage, Private Sector	3.7%	1987 to 2001
Unemployment Insurance (% of Total Wages)	-2.7%	
Workers' Compensation Cost to Employers (% of wages) US	-3.1%	1989 to 2001
Health Insurance (Avg. Cost per Member)	7.3%	
Space		
Office Space (Central Business District)	0.6%	1988 to 2002
Industrial Space (Oahu)	-0.1%	
Median Home Price (Oahu)	3.9%	
Real Property Tax		
Average Tax/Record, All Records	3.1%	
Average Tax/ Record, Commercial	4.7%	
Average Tax/Record, Industrial	3.9%	
Other costs		
Motor Fuel	2.4%	
Auto Insurance	-0.6%	1990 to 2000
Utilities (Cost per KWH, Statewide)	3.5%	

Wages and Fringe: These factors have risen faster than the others considered here. Wages have outpaced inflation over the long term. While unemployment insurance costs have grown, the fastest growth has been in health care costs.

Space: Exhibit 10 includes office and industrial space and, by contrast, median home prices on Oahu. It shows that home values have appreciated more quickly than lease rents.

Real Property Taxes: These have increased somewhat faster than inflation. Increases in commercial and industrial property taxes have been higher than for the entire tax base, reflecting the tendency for the property tax structure to limit

tax increases for other property (through low rates for owner-occupant homeowners; and low valuation of agricultural land).

Other Costs: Over the long term increases in some of the costs which concern businesses and consumers alike have been at or below the rate of increase of inflation. (Had the motor fuel time series gone further back, before the 1973 oil crisis, its rate of increase would have been much sharper.)

SMS considered including other factors. For example, transportation costs are clearly important to business in Hawaii, but no single time series was found that would apply to a wide range of firms.

Different businesses have different cost structures, with some, for example, depending more on labor costs, others on inventory and distribution costs. Over time, the mix of costs has changed as well, with computerization throughout the business world, changes in the size of inventories, and changes in the skills demanded of workers. Clearly, a shopping center operator whose property is on leased land is likely to be more concerned about land prices than a tour bus firm, which could quickly move its base yard and office if the cost of space increased too quickly. While recognizing that different businesses rely more on particular spaces than others, SMS sees no reason to treat the increase in lease rents, which have grown more slowly than inflation, as a major problem for businesses in Hawaii.

The claim in SCR 89 that lease rents have reached "unsustainable" levels is puzzling in light of the obvious facts. Vacancy rates are low, so business in Hawaii is sustaining existing lease rents. Were rents too high, the result would soon be seen in empty stores and warehouses.

IMPACTS OF LEASE RENT ARRANGEMENTS

One argument put forward in proposing SCR 89 was that higher ground rents led to loss of cash that could be used for capital investment. The argument is obvious: if the cost of land is held down, some money can be allocated to other things – wages, investment, profits or other factors. The argument misses two simple points about investment:

First, much of Hawaii's industrial space is old, and little new space is being developed. Higher ground and lease rents make investment in new industrial and commercial space more viable. For Hawaii's economy to grow more quickly, new and better industrial spaces will, sooner or later, be wanted. They are developed as firms are willing to pay the cost of building them – probably at appreciably higher rates than current ones.

Second, changes in the laws governing commercial contracts risk affecting much more than the delimited problem they are meant to address. It is hard to see how a law written to respond to some tenants' concern can be tailored to minimize impacts across the state, on many different sorts of property or contract.

Hawaii's economy has grown through investment from out of state. Japanese firms found Hawaii a safe, if costly, place to invest in the 1980s and early 1990s. More recently, US Mainland firms have brought capital to develop new resort and commercial ventures, or have bought and renovated properties. Although Hawaii is often characterized as unfriendly to business, it still offers a stable economic and legal setting for investors. If, however, it appears that existing and future commercial contracts can be revised by legislative fiat, rather than negotiation by the contracting parties, the investment climate is far less stable.

Hawaii has in recent years made significant changes to residential leasehold law. Leasehold conversion occurs through careful processes, and is designed to recognize the interests of both lessors and lessees. Nonetheless, one result of residential leasehold conversion is that no new residential leasehold property is being developed in Hawaii. Once a property arrangement has been identified as subject to retroactive change because of government concern, the door opens for further changes, and the arrangement may become far too risky to serve as an investment vehicle. Yet, it is hard to see how commercial and industrial space can be developed for Hawaii's small businesses without some reliance on lease arrangements.

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