KANEOHE
RANCH

February 6, 2008

The Honorable Russell L. Kokubun, Chair,
and Members of the Senate Committee
on Commerce, Consumer Protection,
and Affordable Housing
Hawaii State Capitol, Room 407
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to SB 3196,
"Relating to Lease to Fee Conversions"

Dear Chair Kokubun and Members of the Committee:

We are writing to offer our testimony on the above-referenced measure. Unfortunately, we were not aware of this bill until the public hearing had passed, but wanted to make you aware of our concerns regarding this bill, and also give you the background on the situation which apparently prompted the introduction of this measure.

This bill would modify the "right of first refusal provisions" of HRS Ch. 514C to provide that "[w]hen a lessor has displayed an objective intent to sell, or has accepted a written offer to purchase prior to or within two years after the termination of the lease" the association of apartment owners or the cooperative housing corporation would then have the right of first refusal to buy the property "for the same price as is contained in the written purchase offer."

This language is problematic for a number of reasons. First, what is "display[ing] an objective intent to sell?" Who is supposed to determine what is an "objective intent to sell?" It seems the likelihood is that these matters will frequently end up in lawsuits in court.

Second, this right continues for a two-year period after the lease has been terminated. By definition, however, there is no "condominium association" or "cooperative housing corporation" at that point, and there is no one to exercise the right of first refusal.

Third, what is supposed to happen with the property during the two-year period after lease termination? Is the practical result going to be that the property will just sit there blighted and unused until the two-year period elapses?

There are also some obvious legal problems with the bill, especially relating to the language that is supposed to give rights after the lease is terminated. Essentially, this bill would give interests in real property to third persons without compensation, thus opening the State to civil rights suits and "taking" claims by affected property owners. The bill also attempts to rewrite lease contracts to give rights after the lease expires, something the Hawaii Supreme Court has already held unconstitutional. *Anthony v. Kualoa Ranch*, 69 Haw. 112, 736 P.2d 55 (1987) (statute giving improvements to lessees at termination of lease and then requiring lessors to buy them back or extend lease held unconstitutional).

Media stories indicate that this legislation was introduced in reaction to the recent lease expiration with The Kailuan. There has been a lot of misinformation put out in the public about The Kailuan. We think it is important for the Committee to know that this was a unique situation.

Fifty years ago, in 1957, this project was originally leased to a developer for use as market-priced apartment rentals. It was understood that the lease would expire in 50 years and that the area was subject to being redeveloped at that time. While the improvements were appropriate for their intended purpose, there was no concept that they were going to be sold as long-term apartment leases. At the present time, the improvements do not meet current zoning and building standards.

In 1985, the lease was acquired by another developer. The property was converted to a residential cooperative a year later without the lessor's consent. The developer turned around and sold shares in the coop and "proprietary" leases for the apartments (which all expired on December 31, 2007, the same date that the project lease ended), again without the lessor's agreement or consent. Kaneohe Ranch has never received any compensation either from the original sales of the shares and coop units, nor from any of the subsequent resales.

There are 18 units in the project, 17 of which were leased by cooperative shareholders as of the expiration of the master lease. The average price paid for each unit was $24,000. Twelve of the 17 units were purchased after 2000, for an average price of $14,854. Some of the shareholders bought multiple units which they themselves then turned around and rented out.

Consistently, from the time the property was converted to a cooperative over the objection of the lessor to the present, Kaneohe Ranch has made known that it was not going to extend the project lease beyond the scheduled 2007 expiration date. All of the shareholders bought with full knowledge that their interests were only going to extend until 2007 and that they were going to have to make alternative housing arrangements after that date. We think the purchase prices paid by shareholders reflect this knowledge.

Despite this, Kaneohe Ranch did everything it could to minimize the effects of termination on the shareholders. It offered to compensate shareholders for moving prior to termination. It also offered to provide relocation assistance. The shareholders who are now stating that they are being harmed are the ones that refused to accept any assistance from Kaneohe Ranch.

Finally, there was a major longstanding issue regarding the waste disposal system for the property. The Kailuan uses nine cesspools to dispose of sewage from its residents. The cesspools do not comply with present federal environmental law. In July of 2005, The Kailuan cooperative housing corporation entered into a consent agreement with the Environmental Protection Agency, promising that The Kailuan would close the nine existing cesspools by the end of 2007.

When The Kailuan cooperative housing corporation refused to abide by its lease contract, Kaneohe Ranch had no option but to go to the circuit court to seek relief. Judge Kim held a complete evidentiary hearing on the matter, with full opportunity for The Kailuan cooperative housing corporation to present witnesses and evidence, and at the end of the hearing ruled in favor of Kaneohe Ranch.

This unusual situation should not form the basis for any legislation. The primary persons who will be adversely affected if this should become law are the "mom-and-pop" lessors who have allowed condominiums or cooperatives to be constructed on their property, as most of the larger landowners have converted their properties to fee. As we previously mentioned, it is likely this bill will result in blighted properties that will sit unused during the two-year period after lease termination. It will also likely generate litigation between lessors and lessees, as well as claims against the State of Hawai'i for compensation and damages.

For these reasons, Kaneohe Ranch believes that this is not a good piece of legislation and should be held in committee. Thank you for allowing us the opportunity to express our views.

Very truly yours,

H. Mitchell D'Olier
President and
Chief Executive Officer

James R. Steinwascher
Vice President – Leasing

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