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March 10, 2010

LATE TESTIMONY

The Honorable Angus L.K. McKelvey, Chair
House Committee on Economic Revitalization, Business,
and Military Affairs
State Capitol, Room 312
Honolulu, Hawaii 96813

RE: S.B. 2020 Relating to Real Property

HEARING: Thursday, March 11, 2010 at 8:30 a.m.

Aloha Chair McKelvey, Vice Chair Choy, and Members of the Committee:

I am Myoung Oh, Government Affairs Director, here to testify on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 8,800 members in Hawai'i. HAR **opposes** S.B. 2020 which extends Act 189, SLH 2009 to June 30, 2015.

Although HAR empathizes with the lease situation businesses are facing in Mapunapuna, Kalihi Kai and Sand Island, we are deeply concerned with the unintended consequences this legislation may have on commercial and industrial leases in Hawai'i.

Act 189, which went into effect on July 1, 2009, only applies to leases renegotiations when the terms of the lease are based on "fair and reasonable" annual rent. As we noted in our prior testimony in opposition, the measure is a disincentive for lessors to include lease terms requiring a "fair and reasonable" annual rent.

HAR believes that the process of appraisals, mediation, arbitration and as a last option the court system should be the appropriate venue for lease interpretation and contractual disputes.

For the above reasons, we ask the Committee to hold this measure.

HAR looks forward to working with our state lawmakers in building better communities by supporting quality growth, seeking sustainable economies and housing opportunities, embracing the cultural and environmental qualities we cherish, and protecting the rights of property owners.

Mahalo for the opportunity to testify.

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LATE TESTIMONY

March 10, 2010

Representative Angus L.K. McKelvey, Chair
Representative Isaac W. Choy, Vice Chair
House Committee on Economic Revitalization, Business, & Military Affairs

Thursday, March 11, 2010 at 8:30 a.m.
State Capitol, Conference Room 312

RE: SB 2020 - Relating to Real Property

Chair McKelvey, Vice Chair Choy and Members of the Committee:

My name is Jan Yokota, Vice President of the Pacific Region for Reit Management & Research LLC, the property manager for HRPT Properties Trust ("HRPT"). Through its affiliated companies, HRPT owns industrial zoned land in Māpunapuna and Sand Island and in the James Campbell Industrial Park, and, as landlord, leases many of its Hawai'i properties pursuant to long-term leases which provide for the periodic reset of rent to the then "fair and reasonable" rate.

SB 2020 proposes to amend Act 189, Session Laws of Hawai'i 2009, by extending its repeal date from June 30, 2010 to June 30, 2015. As you know, the purpose of Act 189 is to define by statute the meaning of the term "fair and reasonable" in HRPT's leases.

HRPT respectfully, but strongly, opposes SB 2020. HRPT has consistently testified before the Hawai'i State Legislature that actions that seek to change legal contracts, such as Act 189, are unconstitutional. Act 189 violates the Contracts Clause of the U.S. Constitution and is unfair to HRPT for the following reasons:

- Act 189 was targeted at (and continues to target) a single landowner—HRPT, changing the agreed upon terms of previously negotiated long-term commercial and industrial lease contracts, for the sole benefit of a small group of lessees. A state statute violates the Contracts Clause of the U.S. Constitution if the state law:
    - Substantially impairs an existing contractual relationship;
    - Does not have a "significant and legitimate public purpose"; and

- Is without a reasonable and narrowly drawn relationship between the impaired contract and the claimed public purpose.

- Under federal law governing Hawai'i, an impairment of a contract is substantial if, among other things, it alters a financial term or deprives a private party of an important right.

  - Act 189 materially affects the most essential term in a commercial and industrial lease: the lessee's obligation to pay rent.
  - Act 189 re-defines an existing term in an existing contract and would command appraisers and courts to interpret the existing term under this new legislation, contrary to the intent of the original lessor, Damon Estate.
  - As Governor Lingle admitted when she allowed the bill to become law without her signature, the purpose of the Act was to "change the process for renegotiating the amount of rent during the term of an existing commercial or industrial lease" and "this bill impacts the negotiations of lease rent..."

- There is no significant and legitimate public purpose for the Act. The stated purpose of Act 189 is to "maintain close geographic ties between small businesses and the communities they serve" and thereby "stabilize Hawai'i's economy." As the Attorney General advised the Legislature last year, there is no support for the proposition that altering HRPT's contractual rights for the benefit of a few lessees will keep small businesses close to urban communities and that this will, in turn, stabilize Hawai'i's economy. The Act is also targeted at, and impacts, a single landowner and a small number of HRPT's lessees.

In August 2009, HRPT filed a lawsuit in U.S. District Court challenging the constitutionality of Act 189. The case was assigned to Judge Susan Oki Mollway, who held an initial hearing in mid-December and requested that the parties conduct further discovery. Based on the evidence found, HRPT filed a renewed Motion for Summary Judgment, asking Judge Mollway to declare Act 189 unconstitutional.

Judge Mollway scheduled a hearing on this Motion for May 10, 2010. HRPT requested that the hearing be moved up to April 5 or April 12, which were both dates that were available on Judge Mollway's calendar, so that the Legislature could have the benefit of her guidance before the end of this legislative session. The request to advance the hearing was opposed by both the State Attorney General and Citizens for Fair Valuation. It is expected that Judge Mollway will issue a ruling on HRPT's Motion shortly after the May 10, 2010 hearing.

I would also like to take this opportunity to address concerns that have been raised in prior testimony.

- One of the concerns expressed by testifiers is that HRPT's rent reset proposals include "step-ups" and that such "step-ups" are highly unusual. Actually, Damon Estate did negotiate periodic rent step-ups in a number of their leases. In addition,

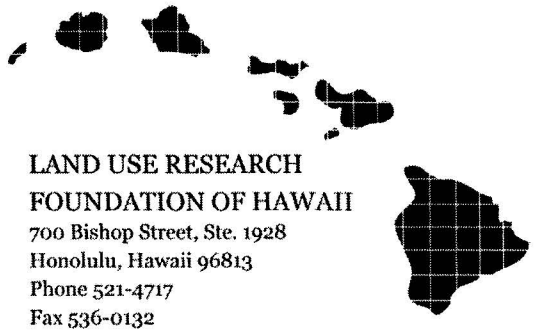
several Māpunapuna and Sand Island lessees have entered into subleases with third parties that include annual step-ups. The Campbell leases provide for annual rent increases based on the Consumer Price Index.

- With respect to rent negotiations, we begin rental discussions with our tenants before the reset date and always attempt first to resolve our rental rates through negotiation. In the past few months, we have come to agreement on lease rent without going through the arbitration process with eleven tenants, including four tenants with leases that include the term "fair and reasonable rent." However, if the parties do not agree, there is an arbitration mechanism in the leases to address a stalemate. In the Servco situation, for example, arbitration was initiated by Servco. Servco's appraiser proposed a rent of $3.65 per square foot and our appraiser proposed a rent of $6.38 per square foot. The three member panel of appraisers set the rent at $5.26 per square foot. The process worked and we can now move forward.
- I also note that we have been providing transaction comparables to commercial real estate brokers and appraisers upon request, where permitted by the leases.
- Finally, regarding the flooding issue in Māpunapuna, we have spent over $750,000 for engineering studies that have resulted in a remedy to resolve the tidal flooding problem. After years of research and planning, the first phase of drainage system improvements is anticipated to commence within one to two weeks, now that approval has been received from the City and County of Honolulu. The project should be completed within two to three weeks of commencement and we anticipate that most or all of the daily tidal flooding will cease.

In closing, we respectfully request that the Committee hold this bill given the pending litigation and the serious questions regarding Act 189's constitutionality.

Thank you for the opportunity to testify on this bill.

LATE TESTIMONY



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March 11, 2010

Opposition to SB 2020 Relating to Real Property
(Sunset date extension re Act 189 - Alteration of commercial lease renegotiation terms)

House Committee on Economic Revitalization, Business & Military Affairs
Hearing Date: Thursday, March 11, 2010 at 8:30 a.m. in CR 312

Honorable Chair Angus McKelvey, Vice Chair Isaac Choy and House Committee on Economic Revitalization, Business & Military Affairs Members,

My name is Dave Arakawa, and I am the Executive Director of the Land Use Research Foundation of Hawaii (LURF), a private, non-profit research and trade association whose members include major Hawaii landowners, developers and a utility company. One of LURF's missions is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources and public health and safety.

LURF respectfully requests that this Committee to **hold this bill, because this measure would extend Act 189, which interferes with the terms of existing contracts, and such alteration of commercial and industrial contracts is unconstitutional, special legislation targeted at one landowner.**

Act 189 (2009): LURF understands that Act 189 was proposed by lessees who claim they are having trouble negotiating their leases with one lessor - HRPT. Act 189 alters the existing terms of HRPT leases by inserting a new definition of "fair and reasonable annual rent." HRPT, which is the sole target of Act 189, has filed a federal lawsuit challenging the constitutionality of Act 189 (HRPT Properties Trust, *et al.*, v. Linda Lingle, in her capacity as Governor of the State of Hawaii, Civil No. 09-0375). We a hope that the federal court case and/or further negotiations, arbitration and mediation can resolve such differences and result in renegotiated leases which can be accepted by both parties.

SB 2020. Act 189 is proposed to sunset on June 30, 2010. This bill, however, proposes to extend that sunset date for five years, to June 30, 2015; provided that the repeal of this Act shall not affect renegotiations of any lease or sublease rental amount, the

renegotiation date for which occurred before July 1, 2015; provided further that this Act shall not apply to any lease scheduled for renegotiation after June 30, 2015.

LURF'S OBJECTIONS. LURF **opposes SB 2020 and the extension of Act 189,** based on, among other things, the following:

- **The stated purpose for Act 189 is not legally justifiable.** Under the circumstances, "stabilizing Hawaii's economy by maintaining close geographic ties between small businesses and the communities they serve" is not a justifiable valid public purpose which would justify altering the terms of existing lease contracts. Act 189 is an unconstitutional violation of the Contracts clause of the United States Constitution. There is no credible evidence that changing the terms of contracts will assure that small businesses stay close to their customers, or that small businesses will fail if they move to another location – this unconstitutional law cannot be "fixed" by merely stating an illogical "purpose and intent" for the bill, without credible facts supporting it. The purported intent and purpose, which is to "stabilize the State's economy," "during the recessionary period," by "preserving the proximity of small businesses to urban communities" **is a "pretext"** (alleged reason, ploy, ruse, red herring, bogus).
  - Is there any "proof" or evidence to support the stated purpose for Act 189? Or, is the stated purpose mere pretext?
  - How many leases will this law effect? The testimony confirms that affect of Act 189 will be limited to the leases with one lessor – HRPT. How will affecting only HRPT leases assure the proximity of small businesses to the urban communities they serve and stabilize the entire State's economy?
  - If that alleged purpose of supporting small businesses were really true, why does the law only apply to leases with one lessor, HRPT?
  - If Act 189 was an attempt to stabilize the economy by changing the terms of lease negotiations - shouldn't the law apply to the terms of all of the existing business leases in the state? Instead, this bill is meant to affect the lease negotiations with only one lessor, HRPT.
  - If the alleged purpose is to truly help lessees, "especially during the recessionary period"- - **Why does SB 2020 extend Act 189 for five years, until June 30, 2015? Is there any evidence that the "recession" will last 5 years?**

- **Act 189 is a "special law" targeted against a single land owner (HRPT Properties Trust), which violates Article XI, section 5 of the Hawaii Constitution.** The proponents private real estate attorney and witnesses who supported Act 189 admitted that the lease alterations in the bill are directed only to one lessor, – HRPT. According to the testimony, there is no other landowners who include the terms "fair and reasonable" in their leases. The proponents' paid legal witness claimed that in the future, there could be other leases which include the terms "fair and reasonable" in their rent renegotiation clauses, however, this is clearly a "class of one" because legislators, the proponents' private real estate attorney, and witnesses in support and in opposition to the bill have all stated that if this legislation passes, no other landowner would be foolish enough to include the term "fair and reasonable" in their leases. Act 189 is a **"special law,"** which is prohibited by the Hawaii Constitution, because it applies to one

particular lease renegotiation provision in the leases of just one particular lessor - HRPT, discriminates against one particular lessor - HRPT, and operates in favor of certain lessees, by granting them a special or exclusive privilege. The proponents of this bill and the Governor have admitted that this bill is to target HRPT; we also understand that the proponents have reportedly testified that the bill is being used as "leverage" in their lease negotiations with HRPT; and there is no testimony or evidence regarding any other lessors in the state who utilize the lease renegotiation language which is the subject of this bill.

- **It is also not responsible and prudent public policy to pass a state-wide 'special law' because of a dispute between one lessor and a group of lessees.** How many state-wide leases are affected? Does a dispute with one lessor warrant a new state-wide law purporting to save Hawaii's economy?

- **It is unfair and unconstitutional to change the terms of existing contracts to favor one party**. The Attorney General has issued prior opinions finding that such alterations in the terms of existing leases are unconstitutional. Moreover, with respect to Act 189, the targeted lessor, HRPT, has submitted testimony and evidence confirming that this legislation would alter historical precedent in defining "fair and reasonable annual rent" in HRPT's prior leases. The term has been defined as "land value multiplied by rate of return" in the following cases: Mapunapuna lease (1997), Pahounui lease (1998) and Moanalua lease (2000).
  - **This Bill substantially impairs the contractual relationship between the lessor and lessee.**
  - The proposed law is **not designed to promote a significant and legitimate public purpose.**
  - The proposed law is **not a reasonable and narrowly-drawn means of promoting a significant and legitimate public purpose**.

- **There is no need for this legislation – current lessees are going through the renegotiation process as provided in the existing contracts.** The written and oral testimony at the various committee hearings on Act 189 confirm that HRPT has successfully renegotiated a mutually acceptable rent rate in dozens of leases which have been up for renegotiation.

- **Other remedies and less intrusive means to achieve public purposes exist – "Don't legislate, just arbitrate."** Instead of creating a new law that alters only HRPT's current lease contracts, the disgruntled lessors should just use the existing rights and remedies in their lease contracts – arbitration, or they could request inexpensive mediation. The written and oral testimony relating to Act 189 confirms that HRPT has always accepted lessees' requests for arbitration and mediation.

- **The Hawaii State Department of the Attorney General (Attorney General) has opined that legislation similar to Act 189 would be illegal.** We believe that in the current Federal court challenge, the provisions of Act 189 will fail to meet the legal test to determine whether a statute is

constitutional under the Contracts Clause, as set forth in the Hawaii Supreme Court case of Applications of Herrick & Irish, 82 Haw. 329, 922 P.2d 942 (1996) and quoted by the Attorney General in its prior opinions relating to other bills which have attempted to alter existing lease terms to benefit lessees:

> "In deciding whether a state law has violated the federal constitutional prohibition against impairments 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."

- **Legislation similar to Act 189, which altered lease terms to the benefit of lessees and to the detriment of lessors, has been found to be unconstitutional by the Attorney General.** Over the past several years, legislation similar to Act 189 has been introduced with the recurring theme of legislatively altering the terms and conditions of existing leases to the benefit of lessees and to the detriment of lessors:
  - In 2008, HB 1075 proposed virtually identical alterations of existing lease contracts to favor the lessee, however, the Senate Economic Development and Tourism Committee (EDT) held the bill. EDT later placed the contents of HB 1075 into HB 2040, SD2, however that bill was held in Conference Committee.
  - In 2007, SB 1252 and SB 1619, proposed virtually identical alterations of existing lease contract to favor the lessee;
  - In 2006, SB 2043, would have imposed a surcharge tax on the value of improvements to real property subject to reversion in a lease of commercial or industrial property;
  - In 2000, SB 873 SD 1, .D 2 also attempted to alter existing lease contract terms to the detriment of lessors and to the benefit of lessees by proposing to alter existing lease terms to require a lessor to purchase a lessee's improvements at the expiration of the lease term. The Department of Attorney General opined that SB 873, SD 1, HD 2 violated the Contracts Clause (Article I, Section 10) of the U.S. Constitution as follows: "SB 873, as presently worded, will substantially impair existing leases without furthering any apparent public purpose... [It is] unlikely that SB 873 will be found to be a 'reasonable and narrowly-drawn means of promoting... [a] significant and legitimate public purpose." Governor Cayetano relied on the Attorney General's opinion, and vetoed SB 873, SD 1, HD 1.
  - In 2001, in response to HB 1131, HD 1, yet another bill which proposed to alter existing lease contracts to favor lessees, the Attorney General again reaffirmed its opinion that the proposed bill violated the Contracts Clause of the U.S. Constitution.
  - In 1987, in the Hawaii Supreme Court case of Anthony v. Kualoa Ranch, 69 Haw. 112, 736 P.2d 55 (1987), the Court ruled that a statute requiring a lessor

to purchase a lessee's improvements at the expiration of the lease term violated the Contracts Clause. The Court observed that:

> "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."

CONCLUSION. The intent and application of Act 189, and proposed SB 2020, which intends to extend Act 189, are unconstitutional, profoundly anti-business and bad public policy, and therefore we respectfully request that **SB 2020 be held in this Committee**.

Thank you for the opportunity to express our **opposition to SB 2020**.