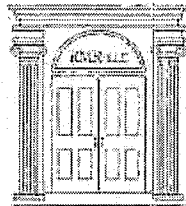


SB2020



Reit Management
& Research LLC
PROPERTY MANAGEMENT
DIVISION

February 18, 2010

Senator Brian T. Taniguchi, Chair
Senator Dwight Y. Takamine, Vice Chair
Senate Committee on Judiciary and Government Operations

Friday, February 19, 2010 at 11:00 a.m.
State Capitol, Conference Room 016

RE: SB 2020 - Relating to Real Property

Chair Taniguchi, Vice Chair Takamine 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. On December 7, 2009, Judge Mollway held a hearing on the case.

At the hearing in federal court on December 7, 2009, Judge Mollway expressed concern “to the extent there’s a change in the bargain that is caused by the passage of a statute because it interprets a term in a way different from what the parties intended at the time of the contract.” Judge Mollway stated on the record: “If there is a change, then there may well be numerous constitutional problems with this statute.”

In mid-December, Judge Mollway issued an order in which she denied the requests from all parties for summary judgment and instructed the parties to conduct further discovery. The discovery process is ongoing and it is expected that Judge Mollway will issue a final ruling on the matter after this process is concluded.

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 nine of our 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 three to six weeks, pending final approval of the State of Hawai'i Department of Health. 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.