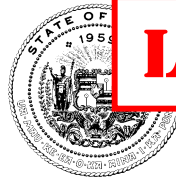


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**LATE**

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DEPARTMENT OF HAWAIIAN HOME LANDS**

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TESTIMONY OF WILLIAM J. AILA, JR, CHAIRMAN  
HAWAIIAN HOMES COMMISSION  
BEFORE THE SENATE COMMITTEE ON HAWAIIAN AFFAIRS  
HEARING ON FEBRUARY 4, 2021 AT 1:00PM VIA VIDEOCONFERENCE

**SB 884 RELATING TO THE HAWAIIAN HOMES COMMISSION ACT**

February 4, 2021

Aloha Chair Shimabukuro, Vice Chair Keohokalole, and members of the Committee:

The Department of Hawaiian Home Lands (DHHL) submits comments on this bill that amends the Hawaiian Homes Commission Act (HHCA) to (1) require appraisals of improvements to identify the replacement cost or the leasehold market value; (2) grant authority to DHHL to authorize second position loans on homestead leases by approved lenders; (3) require DHHL to develop and implement a loan servicing manual, subject to commission approval, to standardize loan loss mitigation policies, procedures, and methods; and to (4) clarify that DHHL shall not cancel a lease solely based on a loan default or delinquency unless all loan loss mitigation procedures are exhausted pursuant to the loan services manual.

Sections 1 and 2 of the bill propose to amend sections 208(6) and 209(b) of the HHCA to require appraisals to identify the leasehold market value in conformance with methods and standards applicable to other leasehold properties across the State. The issue is that DHHL homestead leases (i.e., DHHL leaseholds) are not like other leasehold properties in Hawai'i. The term leasehold is and refers to a lessee's right to exclusive use and possession of a tract of DHHL land for a term of years. DHHL leaseholds can only be owned by qualified beneficiaries. Consequently, the market for DHHL leaseholds is limited by statute.

This unique limitation affects the availability of private and federally-insured financing for DHHL leaseholds and how DHHL property can be appraised for a lenders' underwriting. For example, HUD, which implements the FHA-insured Section 247 mortgage program, considers the market for DHHL leaseholds as a closed market. Because the leasehold cannot be sold on the open market, it has no comparable value. It therefore underwrites FHA-insured mortgages only on the replacement cost of the leasehold improvements, ascribing no value to the leasehold. Requiring appraisals of DHHL leaseholds like other leaseholds may put private lenders and federal agencies at odd with the requirements of the HHCA and their underwriting requirements.

Requiring the appraisal of the leasehold like other leasehold properties in Hawai'i may also lead to windfalls for some and severe financial burdens to successors of Hawaiian homes leases. For example, under Section 209, when a lessee dies without a designated or qualified successor, the leasehold improvements are appraised, any existing debts deducted, and the balance, known as "net proceeds" must be paid to a qualified recipient. Currently, the qualified recipient receives the equity in the leasehold improvements, which the lessee financed and paid for. Requiring the appraisal of and ascribing value to the leasehold on a 99-year lease, would inflate a qualified recipients net proceeds with "equity" in DHHL's land, which the lessee had not financed and only paid nominal consideration for (i.e., \$1 per year). The problem is compounded because the department is also required to treat the payment of "net proceeds" as an advance, which the successor or ultimate transferee of the lease must pay back.

Section 3 of the bill would amend section 210 of the HHCA to prohibit lease cancellation based solely on a loan delinquency or default, unless all loan servicing procedures identified in the loan servicing manual have been exhausted. The HHC has asked 33 lessees to leave their homesteads over the last five years which is less than 1 percent of the total number of mortgages on the homelands. A 2013 audit report also criticized the HHC for failure to "collect delinquencies or cancel accompanying leases," stating that it runs counter to the trustee duty of impartiality by elevating an individual delinquent lessee's interest above other beneficiaries. If DHHL staff does not find success with curing a lessee's inability to pay a mortgage, for a myriad of reasons, the case is then referred to the HHC, which has an extensive lease cancellation process. The process includes multiple and ongoing hearings with the Commission on the lessee's island to prevent travel costs, loan modification options, and additional financial counseling. A lease may only be cancelled by a quorum of five commissioners and a majority vote. Once a lease is cancelled, a lessee can even seek reconsideration or appeal under HRS Chapter 91.

Section 4 of the measure would amend section 216 of the HHCA permitting DHHL to authorize second position loans on homestead leases by approved lenders and requiring DHHL to develop and implement a loan servicing manual, subject to commission approval, to standardize loan loss mitigation policies, procedures, and methods. DHHL already has over 4700 loans totaling over \$600 million. Authorizing second position loans could require additional sources of loan financing to existing lessees while nearly three times that number are awaiting a lease and financing for their homestead award. DHHL has written loan servicing guidelines and Department staff work one-on-one with lessees who are experiencing challenges in paying their mortgages. These challenges may include, but are not limited to, job loss, a medical emergency, or a family crisis. In addition, loan officers with DHHL provide payment options and financial counseling paid for by the Department. To ensure the availability

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of adequate assistance, lessees are contacted by postal mail, phone, e-mail, and through in-person visits, if necessary.

Thank you for your consideration of our testimony.