Leasehold Perspective

By Michael Pang
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Residential leasehold began in the 1950's as a means to create more housing for post-war Honolulu, which was experiencing a shortage. While many landowners did not want to sell, developers were able to convince them to lease their land in return for income, improving their property and getting it back at the end of the lease. This well-intentioned system did create more housing, but it was doomed to fail because the model was misapplied from commercial leasehold concepts. The reversionary or surrender clauses in the leases (what returns the land to the landowner) will inevitably displace the residents from their homes and uncapped lease rent increases, tied to land value fluctuation, creates difficult-to-afford lease rents. These realities eventually placed social conscience (saving peoples homes) in conflict with the terms of the lease contract.

As early as 1967, government responded to the social plight by mandating sales of leased fee, first for single-family homes (Land Reform, Chapter 516, HRS) and then for condos, co-ops and PUDs (Chapter 38, ROH). Despite the adverse social effects of residential leasehold and that government was intervening into the lease contract, landowners and developers proliferated residential leasehold to unprecedented levels in the 60's, 70's and 80's. At one time there were about 25,000 leasehold single-family properties and over 60,000 leasehold apartments statewide.

Federal and State Supreme Courts have upheld the constitutionality and public purpose of Hawaii's mandatory fee conversion laws, essentially agreeing that we must get out of our antiquated residential leasehold system, if not voluntarily then involuntarily. However, opponents to leasehold reform continue to challenge these laws. Today, because most legal challenges with reasonable basis have been raised and adjudicated, their focus is now on political repeal or hindrance.

In the current legislative session, HB675/SB633, which sought to exempt Hawaiian (Alii) trusts from condemnation for fee conversion purposes, has failed along with SB261, which would have disqualify lessees who bought their apartment after 6/21/91 from being eligible for mandatory conversion. Recently, Ezra Kanoho (Chair of the House Water, Land Use and Hawaiian Affairs Committee) sponsored a bill (SB1468, HD1, SD1) to prevent counties from using their power of condemnation (eminent domain) for leasehold reform purposes (the basis of Chapter 38). Once discovered, lessee groups heavily lobbied against this bill and as a result it appears to be failing as well.

At the county level, things were fairly quiet and Chapter 38 was being successfully implemented from October 1998 until May 2002 when the "Coon" decision made qualification for the law more stringent. This reenergized opponents who have since made numerous attempts to repeal Chapter 38. If history repeats itself, after exhaustive efforts fail to

cripple Chapter 38 the furor of opposition should again diminish, until something else occurs to reenergize opposition.

In addition, the City Council recently approved a task force to make recommendations on revising Chapter 38 with the objective of making it less controversial and hopefully more inclusive. That process revealed a sense that the new Council does not favor repeal of Chapter 38, but also does not want the contentiousness that has been the norm the past 12 years. The task force will have at least 6 months to present its findings to the Council for consideration and as such, nothing should change until late this year or early next.

The other useful result of these mandatory fee conversion laws is regulation of pricing. This is appropriate because of the closed market nature of fee conversions (one seller and one most practical buyer) and the lack of a balanced playing field (market) without regulation. Experience has proven that left unchecked landowners will naturally seek methods to get the highest price possible, even if it takes advantage of the typical emotions and lack of knowledge among lessees. Market data has proven this.

Condemnation for fee conversion has at its tail end litigation to establish a fair price if one is not negotiated beforehand. Litigation is a process that relies on appraisals and appraisal opinions, not emotion and lack of knowledge in the marketplace. Under Chapter 38, some landowners have agreed to prices 40% to 45% less than what they had been asking, to settle their condemnation actions. In the reverse, for some of the projects that were rendered ineligible last year due to the Coon decision, the landowners have already increased their asking prices, in one case three times in a short span of time. If left unchecked, the imbalanced nature of residential leasehold will again increase prices sought to unfair levels and lead to more contention.

Residential leasehold is an antiquated system that was doomed to fail from its inception. Getting out of it serves everyone's interests including landowners who can profit in reinvestment. This is especially true for eleemosynary trusts that reinvest tax-free. A prime example is Kamehameha Schools ("KS"). Not too long ago KS was an asset-rich, cash-poor entity having some difficulty meeting operating costs. Today, KS is an international investment giant with the cash to expand programs and help more of its beneficiaries. The difference is that KS smartly enriched itself with voluntary fee conversion sales.

Fee conversion is the best win-win resolution to this dilemma. Lessors profit in reinvestment and lessees keep their homes. The error of our residential leasehold system appears to be shortsightedness by all involved - those who created it, lessees and lessors. The error of a past generation will have to be fixed by this one. Lessors and lessees should not blame each other and kokua to get out of a difficult situation. Everyone will benefit from this.

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