

# PROPERTY BATTLE LINES

Landowners and lessees struggle to retain their interests as the debate over mandatory leasehold conversion becomes emotionally charged

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When Mike Street was a child in the 1960s, his grandfather transformed the family's 14-unit apartment complex in Waikiki into a leasehold condominium. That move ensured lease rent income for him and his five brothers and sisters.

Street declined to say how much income is derived from the lease rents, but "for some family members, it comes in handy."

Like other small landowners, Street objects to the city having the power to force his family to sell the leased fee interests to lessees with whom the landowners have signed contracts.

Elsewhere in Waikiki, Robert Malandra lives in the same tiny, Ala Moana Boulevard studio he purchased in the 1980s.

Gazing at the spectacular view of Fort DeRussy and the ocean beyond it, Malandra thinks about being 85 years old when his lease runs out.

By seeking the fee interest on the unit, Malandra said, he just wants to make sure his new wife can live there in case he's not around.

"I'm not the greedy person they're making us out to be," he said.

So go the two sides in the debate over mandatory conversion for leasehold condominiums that has exploded once again since a Hawaii Supreme Court decision in May.

The Honolulu City Council, over the next two weeks, will likely decide if thousands of lease holders can use the city's powers of eminent domain to compel a landowner to sell.

Since mandatory leasehold conversion became law more than five years ago, the city has accepted applications from either 25 owner-occupants or 50 percent of owner-occupied units.

The Supreme Court decision, while validating the city's use of condemnation for mandatory conversion, said the city misinterpreted its own law and should only have considered petitions with 25 owner-occupants or 50 percent of all units in a complex, not just owner-occupied units.

Realtor Michael Pang, who handles many conversion applications, estimates the number of eligible condominiums would drop to 37 from 360, while the number of eligible lessees would shrink to 2,500 from 5,700, if the city doesn't address the court decision. The city says that active petitions by lessees of 12 of 17 projects were made ineligible by the ruling.

Bill 53 would once again allow 50 percent of owner-occupied units. Councilman John Henry Felix, who co-authored the 1991 leasehold conversion law, called the bill nothing more than a housekeeping measure.

But a final vote on the issue has been stalled more than two months following a narrow, 5-4 second reading vote in July. That meeting featured overwhelming testimony not only by landowners, but members of native Hawaiian civic organizations who say the Queen Liliuokalani Trust is in danger of losing a key revenue source because of condemnation action against the Foster Tower condominium, which sits on trust land.

## **Liliuokalani dispute**

The petition by eight of 14 owner-occupants in the Waikiki tower, which has 141 residential leasehold units, has been delayed for months.

Lono Correa of the group Kupaa Mahope O Liliuokalani said the attempt to take away land from the trust endowed by Hawaii's last reigning monarch is a sensitive issue for native Hawaiians.

Proponents of mandatory conversion have suggested that the trust could quickly recoup all its lease rent and redevelopment value through prudent reinvestment. Correa, however, said: "For us, it is not about the money, it's about the legacy. It's the second great insult."

While only a small number of owner-occupants in the tower have petitioned, trust officials say a successful conversion action could have broad impacts on not just its revenue stream but the future use of the land. "Even if a small number convert from leasehold to fee simple, they obtain the power to block future redevelopment of the project," said Robert Ozaki, the trust administrator.

A proposed "compromise" amendment to Bill 53 introduced last week was designed in large part to take Foster Tower out of condemnation's reach until lessees can find two more to join their action. The amendment would require that the city not consider any petitions with fewer than 10 owner-occupants from a single complex. But trust officials and landowners say the amendment does not change their opposition to the bill.

## **Different interpretations**

Louanne Kam, senior counsel for Kamehameha Schools, said the court's ruling concurred with the trust's long-time argument that mandatory conversion should only be applied in cases of "bulk condemnation." The way the city interpreted the law, even a single leaseholder could qualify, she said.

The Council's 1991 law was patterned after the Hawaii Land Reform Act of 1967, the state law that paved the way for single-family conversions. That law said condemnations should only be conducted "in bulk," Kam said.

Councilman Steve Holmes said the intent of the 1991 law was to open the process to as many lessees as possible. That led to the 50 percent owner-occupant requirement, he said.

Sally Cravalho, the city's leasehold conversion program coordinator, points to language that states that "condominium owners means the owner-occupants of the condominium development."

Pang also believes the one-lessee scenario is an unrealistic premise because it would be cost-prohibitive. The average conversion costs about \$50,000 including attorney fees, appraisal costs and escrow, excluding actual purchase price of the fee. Kam, meanwhile, disputes Pang's analysis of the numbers and believes only 1,498 owner-occupant lessees in 226 projects would benefit from Bill 53.

### **Huge consequences**

Landowner attorney James Mee said his family was among those who were persuaded by developers in the 1960s to put up a condominium on their property.

At the time, Mee said, the city tried to concentrate growth in urban Honolulu, in part, by redesignating single-family neighborhoods into high-density zones, which came with higher taxes.

While landowners typically had to come up with the capital themselves for rental apartment complexes, developers often picked up the tab for a leasehold project and promised not just monthly lease rents but also the return of all interests at the end of the lease period, typically between 40 and 60 years.

Lessees were enticed by the promise of home ownership and the accompanying tax breaks, Mee said.

Phyllis Zerbe, a leader for the Small Landowners Association of Hawaii, said the system worked and would be OK if government did not use the threat of condemnation and give negotiating power to the lessees.

Landowners, she said, did not complain about being locked into obtaining "minuscule" lease rents "even as we saw inflation make our lease rents worth next to nothing and saw massive speculation going on in resales of leasehold apartments." Lessees, she said, should not complain about abiding by their contracts.

Realtor Pang, however, said what the crafters of residential leasehold in Hawaii failed to grasp were the social repercussions waiting at the end of the lease terms.

"They created a system that was doomed to fail," Pang said. "It's not the lessees fault, it's not the lessors fault."

Aimee Tang said she pays roughly \$42 in monthly lease rent to her landowners for her two-bedroom condominium at the Alika near Punahou School. But that's above the \$650 mortgage and \$264 in maintenance, she said.

Tang, who is 57, said she is disabled and on a fixed income with little savings after raising two children. "I have no other options," she said when asked what would happen if landowners opt not to renew the leases.

About 13 of 19 owner-occupant lessees in the 45-unit Alika have petitioned for a condemnation, and it is on hold pending passage of Bill 53.

Tang said it makes no sense to her because she figures the two families who own the land make a total of \$1,500 in lease rent. Alika's condominium association offered \$900,000 for the fee interests on all 45 units. Tang said that would mean the landowner with the smallest share, 20 percent, would get \$180,000.

The owners have countered with an offer of \$2 million.

"I don't want to be on the street, and I don't want to live with my children," Tang said. "Let me live the rest of my years here in peace."

Zerbe, while insistent that small landowners should not have to bear the brunt of the lessee's plight, said peaceful resolutions can be achieved without government intervention.

"I can't predict the future, but I can't see landowners at the end of the leases kicking people out unless it becomes absolutely necessary," she said. "I would think that things might be able to be resolved."

# Pro and Con

## Bill 53 pros

Proponents of mandatory conversion of leasehold condominiums and Bill 53 say:

>> Society benefits when owner-occupant lessees get the security that comes from purchasing the fee on their homes at fair prices. Leasehold condominium development was pushed in the 1960s and 1970s in an effort to meet Oahu's housing shortage, but those who devised the system did not foresee the social ramifications of displacing people from their homes at the end of the lease terms.

>> Courts have ruled repeatedly that leasehold conversion is a proper use of the city's condemnation powers. Bill 53 simply clarifies that intent. The one-lessee argument is specious because it would not be feasible for one party to start such an action.

>> More lessees are reaching a point in their contracts where they need to renegotiate their lease rents and fear needing to pay substantially more at a time in their lives when many of them can least afford it.

>> Landowners would receive fair-market compensation from the sale of their units and, given prudent reinvestment, should be able to earn more than the lease rent they collect and the redevelopment value of the land at the end of the lease.

## Bill 53 cons

Opponents of mandatory conversion of leasehold condominiums and Bill 53 say:

>> No public purpose is served when the city's condemnation powers are used to benefit one party over another in a private business situation.

>> Lessees signed a legally binding contract stipulating that their leases would end at a specified date, while owners anticipated getting their properties back at the end of the agreement. If lessees were promised more, it's not the lessors' fault.

>> The Hawaii Supreme Court said there must be "condemnation in bulk," and Bill 53 could allow even one owner-occupant to start a condemnation action. Bill 53 therefore is unconstitutional and will touch off more litigation.

>> Lessees benefited from being required to pay monthly lease rents that have been locked in for two, sometimes three, decades and should have been preparing during that time to move elsewhere.

>> Landowners being forced to sell their lands would have to give up steady income and instead have to find investments in a sometimes unstable, but never guaranteed, investment world.

>> Mandatory conversion flies in the face of the free-market system by using the city's condemnation powers to force landowners to sell, and to sell at prices they don't want.

# What to know about the leasehold debate

**Question: What is the residential leasehold system?**

**Answer:** The residential leasehold system was established to create more affordable ownership opportunities for Hawaii residents during the housing shortage of the booming 1950s. It allowed for homes to be built and sold to home buyers on land with long-term leases, typically between 40 and 60 years, with the caveat that the landowner would retain the leased fee interest on the land below.

**Q: What is the purpose of condominium lease-to-fee conversion?**

**A:** Chapter 38 allowed for government to use its condemnation powers to compel landowners to sell the leased-to-fee interests to allow lessees with long-term contracts and who are owner-occupants "to purchase at a fair and reasonable price the fee simple title" to their home.

**Q: But weren't there signed contracts?**

**A:** Landowners have argued that lessees knew they would lose their lease interest at the end of the terms in their contracts. Lessees say the courts knew, in upholding the ordinance, that long-term leases were involved and found that their argument, the fear of losing their homes, was more compelling.

**Q: In the conversion process, who determines the price?**

**A:** The price is determined either by agreement of the parties during negotiation, or the decision of a judge or jury in an eminent-domain action. Chapter 38 states that the landowner must be paid fair-market value for the property, plus applicable damages.

**Q: How do lessees qualify for mandatory conversion?**

**A:** Qualified lessees must own no other fee simple property on Oahu suitable for residential purposes and must have lived in the unit for a minimum of one year prior to the application to the city. They must also declare Hawaii as their principal home and where they file resident tax returns. They must then group together with enough other qualified lessees within a project to approach the city.

**Q: How many qualifying lessees are needed before a mandatory conversion action can be processed on their behalf?**

**A:** This is the crux of the current debate. The city has been using as its minimum threshold either the lower of a) owners of 25 owner-occupied units or b) owners of 50 percent of the owner-occupied units in a project. The Hawaii Supreme Court, in May, invalidated an administrative rule. In essence, it ruled that it had no problem with the 25 owner-occupant threshold but that the percentage threshold really should be 50 percent of ALL units in a project, not just owner-occupants.

**Q: What impact did the Supreme Court's decision have in terms of who could qualify?**

**A:** According to Realtor Mike Pang, a leading proponent of mandatory conversion, the number of eligible condominiums under this interpretation drops to 37 from 360 while the number of eligible lessees goes to 2,500 from 5,700. The city says that active petitions by lessees of 12 of 17 projects were made ineligible. Kamehameha Schools, which disputes Pang's numbers, believes 1,498 owner-occupants at 226 projects have been disqualified.

**Q: What does Bill 53 do?**

**A:** Introduced by Councilman John Henry Felix, one of the key forces behind Chapter 38, Bill 53 seeks to once again allow 50 percent of owner-occupants to petition the Council for mandatory conversion. Proponents say this is a clarification of the existing practice because 50 percent of owner-occupants was always the intent. Opponents say the bill flies in the face of the Supreme Court decision and that it would allow only small numbers, perhaps as few as one owner-occupant, to determine whether a mandatory conversion action takes place. A new version of the bill requires no fewer than 10 lessees to apply.

**Q: How is Queen Liliuokalani Trust affected by all this?**

**A:** The trust owns four leasehold towers in Waikiki that bring in about \$15 million annually, up to 15 percent of total revenues, for more than 300 social service programs. Lessees of eight out of the 14 owner-occupied units at the Foster Tower condominium filed for a mandatory conversion action, which the Council has deferred.