



KA NU HOU



"The News"

January 1998

FROM THE CHAIR

Happy New Year and welcome to our new board members, Bruce Graham, Rick Kiefer, Stan Kuriyama and Trudy Burns Stone, and to our new Section members. Our Section continues to be one of the largest sections in the Hawaii State Bar Association. We have maintained a membership of over 300 and have continued to provide great benefits to our membership.

Last year was an especially busy and productive one. I want to personally thank David Callies for a great job as Chair. In 1997, under his leadership, we presented the Hawaii Water Law seminar in May, the Legislative Update and Litigation Update seminars in July and October, respectively, the Land Use Seminar in November, and finally the 2-day Hawaii Real Estate Law seminar held in conjunction with the Hawaii State Bar Association Convention. Also under David's tenure, we began holding regularly scheduled executive committee meetings with the officers and out-going Chair, a practice we will continue. In addition, David was instrumental in beginning a dialog with the HSBA to discuss how the HSBA can better assist the sections. This meeting also familiarized all section chairs with the types of services other sections provide to its respective section members.

In 1998, we will continue to organize and present seminars of interest to our membership, in addition to continuing to present the Legislative and Litigation Update seminars. We have informally polled our membership and Board and topics of interest for this year include Time Share Developments, Assisted Living Projects and Title and Registration matters. We encourage you to voice your suggestions either through our Web Site (<http://www.hsba.org/section/rpfs/index.html>), or by contacting any of our Board members whose names appear on the last page of our quarterly newsletter.

In addition to the seminars, the Board will continue to monitor legislation and through our Web Site, Nancy Grekin will post legislation that may be of interest to you. We cannot thank Nancy enough for her time and energy in creating our Web Site. Please feel free to e-mail Nancy with suggestions, cases or anything else you feel may be of interest to our members. If you have not yet sent your e-mail address to her, please do so.

Also, prompted by requests from the members who attended the Hawaii Real Estate Seminar, the Web Site will contain information about which sections of the earlier manuals have been superseded by the new 3-volume manuals produced for the seminar. HICLE has also informed us that the missing articles will be distributed in February.

Randy Brooks is the 1998 Editor of our quarterly newsletter. A special thanks to Rick Kiefer, one of our new Board members, for this issue's article entitled "1997 Act 135's Amendments to Hawaii's Condominium Development and Marketing Laws" wherein he discusses the 1997 Act 135 which streamlined Chapter 514A's statutory requirements for the marketing of residential condominiums. We are pleased that both Randy, Chair-Elect for 1998, and Rick Kiefer, are involved in condominium development and can keep the membership informed on all of the latest developments and law in this area.

Randy is actively seeking articles for our April issue of the newsletter. Our July and October issues will contain the winning essays by William S. Richardson Law School students from their seminars in property and environmental law. We are pleased that your dues allow our Section to present a scholarship award to both of these students, in addition to the inclusion of their articles in the newsletter.

Finally, I want to invite you to attend our Board meetings which are held every third Friday of the month, at noon, in the large conference room in the HSBA offices at 1136 Union Mall. Our meeting dates are set forth on the last page of each issue of the newsletter. I look forward to serving as your Chair in 1998 and hope to see you either at our Board meetings, our seminars, or around town.

Sincerely,

Sheila L.Y. Sakashita

Sheila L.Y. Sakashita, Chair

Real Property and Financial Services Section



1997 ACT 135'S AMENDMENTS TO HAWAII'S CONDOMINIUM DEVELOPMENT AND MARKETING LAWS

By Richard Kiefer, Esq.*

In 1997, the legislature enacted several major amendments to Hawaii's Condominium Property Act, Chapter 514A, Hawaii Revised Statutes ("Chapter 514A"). For condominium developers, the most important of these amendments may be 1997 Act 135 ("Act 135"), which streamlined Chapter 514A's statutory requirements for the marketing of residential condominiums and lowered some of Chapter 514A's hurdles to condominium development. This article outlines the problems with Chapter 514A that Act 135 was intended to address, recounts the history of Act 135, and describes Act 135's effect on condominium marketing and development.

Background

Condominium development has increased home ownership and fueled a significant portion of the State's construction industry. Because land available for single-family home development is becoming increasingly scarce, condominium development has emerged as a growing component of the new housing market in the State, particularly within the urban core of the City and County of Honolulu.

To ensure that all condominium purchasers are adequately informed regarding a condominium project, Chapter 514A prohibits a developer from marketing apartments in a condominium project until the State Real Estate Commission has issued an effective date for the developer's Condominium Public Report. This report must describe and disclose material information

regarding the project and, prior to 1997, could be either in the form of a Preliminary, Final or Supplementary Public Report.

A Preliminary Public Report generally is issued before all material elements of the development of a project have been finalized. Developers have traditionally used Preliminary Public Reports to test market feasibility before deciding to proceed with a development. Because a Preliminary Public Report is subject to change, Chapter 514A provides that where only a Preliminary Public Report has been issued, contracts to purchase condominium apartments are not binding and that purchasers' deposits must be held in escrow.

Prior to 1997, Chapter 514A allowed the Commission to issue an effective date for a project's Final Public Report only when the developer had (1) finalized and recorded the project's plans and organizational documents, (2) acquired the land on which the project was to be developed, (3) completed construction documents, including specifications, (4) secured construction financing and building permits for the project, (5) executed a contract for the construction of the project, and (6) obtained a 100% performance and payment bond. Because a purchaser was deemed to be adequately protected only when a developer had satisfied all of these requirements, prior to 1997, Chapter 514A provided that a contract to purchase a new condominium apartment from the developer became binding only after the purchaser received the Final Public Report and had a 30-day period to review and approve it.

Chapter 514A thus required developers to incur virtually all of the costs and risks of development, such as design, land acquisition, financing (debt and equity), construction contracts, bonds, building permits, and

other development costs, before being able to bind purchasers under a Final Public Report. This requirement, however, ignored the fact that, in the current economic climate, banks and other construction lenders generally will not provide financing for a condominium project until after a Final Public Report has been issued, the developer has "presold" most of the apartments in the project, and the purchase contracts for those apartments have become legally binding. Developers were thus forced to put significant amounts of their own funds at risk — or to secure expensive financing from investors willing to bear these risks — before the developers knew whether a project was feasible and could go forward. This created a significant financial and development hurdle that many condominium developers were unwilling or unable to overcome, especially for small development companies with less capital to put at risk. It also created an environment that made it difficult for small local development companies to compete successfully with foreign or out-of-state companies that are well capitalized.

Chapter 514A also requires the developer of any residential condominium project to designate at least fifty percent of the residential apartments in the project for sale to qualified "owner-occupants" (that is, buyers who intend to use the apartments as their principal residence for at least one year after their purchase closes). Prior to 1997, Chapter 514A required that the apartments designated for sale to owner-occupants be marketed to prospective owner-occupants before the project was offered for sale to the general public under either a Preliminary or Final Public Report. During this limited, separate marketing phase, the developer was required to publish an announcement of its sale of units to owner-occupants that was approved in advance with the Real Estate Commission and, because no Public Report

had been issued, contained detailed information on the project. The developer was then required to compile a list of prospective owner-occupant buyers, using either a chronological or lottery system, who would be offered purchase contracts on the designated units after issuance of a public report on the project.

After assembling a list of potential owner-occupant purchasers in this first marketing phase, the developer then traditionally tested market feasibility by offering its project for sale to the general public under a Preliminary Public Report, rather than a Final Public Report, because of the costs required to obtain a Final Public Report. The developer would ultimately, however, have to secure a Final Public Report in order to bind its purchasers under their purchase contracts. Thus, developers of residential condominium projects often found themselves marketing their projects in three distinct phases: first to owner-occupants only; then to the general public under a Preliminary Public Report; and then to the general public under a Final Public Report.

Requiring owner-occupant sales to occur before the issuance of a Public Report, however, unnecessarily complicated the owner-occupant process because a developer could not offer sales contracts on the apartments that owner-occupants select until a Public Report was issued, thus adding additional steps and costs to the sales process. The ban on marketing to non-owner-occupants before the issuance of a Preliminary or Final Public Report also made it more difficult to test-market a project to the general public, a critical step to determine a project's market feasibility. Finally, Chapter 514A required extensive and often expensive documentation and filings with the Real Estate Commission for each of the three marketing phases.

The History of Act 135

These hurdles to condominium development in Chapter 514A posed a significant impediment to many condominium developers in the tough condominium development market of the mid-1990s and motivated them to seek legislative reforms. This reform initiative began in 1996 when, in response to the efforts of members of the development community, the State Senate passed 1996 Senate Resolution Number 207 ("Resolution 207"). In this Resolution, the Senate stated that "over the years, Hawaii's condominium laws have become an amalgam of diverse regulations which, although well intentioned, have contributed to higher condominium home ownership costs and have increased capital costs and risks to developers" and that in "today's mature condominium project market" many of Chapter 514A's development and marketing restrictions were "unnecessarily stringent." Based on these considerations, the Senate in Resolution 207 called on the State Real Estate Commission "to convene a private sector task force . . . composed of condominium developers, real estate brokers, property managers, lenders and other interested members of the private sector." Resolution 207 then instructed that task force to work cooperatively with the Real Estate Commission and other interested members of the public sector "to propose legislation amending [Chapter 514A] to reduce costs and risks to developers while maintaining provisions to ensure that the public is protected against the loss of purchasers' funds and speculation in the initial sale of condominium projects."

In response to Resolution 207, a private sector task force was organized in late 1996. This task force included a number of condominium developers, members of the real estate sales community, and condominium development attorneys. This pri-

vate sector task force was informally led by The Myers Corporation, which experienced Chapter 514A's hurdles to development first-hand while developing One Archer Lane, a 41-story, mid-market condominium project in Kakaako.

During late-1996 and early-1997, the task force worked with the Real Estate Commission to develop draft condominium reform legislation. This draft legislation was introduced into the 1997 legislature in the form of companion bills: House Bill 793 and Senate Bill 1361. This legislation was supported throughout the legislative process by members of the private sector task force, other members of the development community, and, perhaps most importantly, the Real Estate Commission. With this support, House Bill 793 eventually passed successfully through both houses of the legislature and was signed into law by Governor Cayetano on June 16, 1997 as Act 135. The Act became effective on July 1, 1997.

Act 135's Major Changes To Chapter 514A

Easing Statutory Hurdles to Development

Act 135 enacted two major reforms of Chapter 514A. First, Act 135 addressed the problems created by the fact that Chapter 514A required a developer to incur virtually all of the costs and risks of development before it could bind its purchasers under their purchase contracts by securing an effective date for a Final Public Report, notwithstanding the fact that project financing was generally not available until after a developer "presold" most of the units in a project and the purchase contracts for those units became legally binding. Act 135 addressed this problem by creating a mechanism by which a developer can bind pur-

chasers under their purchase contracts, thereby allowing the developer to satisfy its lender's requirements, before the developer has incurred some of the most significant costs and risks of development.

Specifically, Act 135 created a new section of Chapter 514A, Section 514A-39.5, which allows the Real Estate Commission to issue an effective date for a "Contingent Final Public Report" on a project. As with a Final Public Report, purchasers who receive a Contingent Final Public Report and waive their statutory cancellation rights are bound under their contracts. See Haw. Rev. Stat. § 514A-62(a). Unlike a Final Public Report, however, Chapter 514A allows a developer to secure an effective date for a Contingent Final Public Report before the developer has closed its acquisition of the project site under an option agreement, secured its project financing, and, in the case of a newly constructed project, executed a construction contract, pulled its building permits and secured its construction bonds. See Haw. Rev. Stat. § 514A-39.5.

Since these amendments to Chapter 514A allow purchasers to be bound under their contracts before significant components of a development are in place, Act 135 also enacted several accompanying buyer protections. First, Chapter 514A, as amended, provides that a Contingent Final Public Report expires nine months after its effective date and may not be extended or renewed. See Haw. Rev. Stat. Sec. 514A-39.5(c). If a developer does not secure an effective date for a Final Public Report before the Contingent Final Public Report expires, the developer must give its purchasers an opportunity to rescind their purchase contracts. See Haw. Rev. Stat. Sec. 514A-64.5(b). If the purchasers elect to rescind, the developer must promptly refund their deposits in full with interest, reimburse any

escrow fees they incurred and, if the developer required the purchasers to secure financing commitments, reimburse any financing commitment fees they incurred. *Id.* Finally, Act 135 also amended Chapter 514A to provide that all Contingent Final Public Reports contain the following disclosure:

The effective date for the Developer's Contingent Final Public Report was issued before the Developer submitted to the Real Estate Commission: the executed and recorded deed or master lease for the project site; the executed construction contract for the project; the building permit; satisfactory evidence of sufficient funds to cover the total project cost; and/or satisfactory evidence of a performance bond issued by a surety licensed in the State of not less than one hundred per cent of the cost of construction, or such other substantially equivalent or similar instrument or security approved by the Commission. Until the Developer submits each of the foregoing items to the Commission, all Purchaser deposits will be held by the escrow agent in a federally-insured, interest-bearing account at a bank, savings and loan association, or trust company authorized to do business in the State. If the Developer does not submit each of the foregoing items to the Commission and the Commission does not issue an effective date for the Final Public Report before the expiration of the Contingent Final Public Report, then (1) the Developer will notify the Purchaser thereof by certified mail and (2) either the Developer or the Purchaser shall thereafter have the right under Hawaii law to rescind the Purchaser's sales contract. In the

event of a rescission, the Developer shall return all of the Purchaser's deposits together with all interest earned thereon and, if the Developer required the Purchaser to secure a financing commitment, reimburse any fees the Purchaser incurred to secure that financing commitment. Haw. Rev. Stat. Sec. 514A-64.5(c).¹

These changes to Chapter 514A will allow developers to minimize some of the significant up-front costs and risks that until 1997 increased the cost of condominium housing. For example, condominium developer Peter Savio of Savio Development Co., Inc. estimated, in testimony in support of Act 135, that these changes could result in savings in his condominium conversion projects of \$3,000 to \$4,000 per unit and would result in reduced prices for buyers. Importantly, however, these changes should not increase the risks to condominium purchasers because of the strict buyer protections that Act 135 enacted.

Streamlining Condominium Marketing

As discussed above, until 1997 Chapter 514A generally required a developer to market a project in three distinct phases: first to owner-occupants only; then to the general public under a Preliminary Public Report; and then to the general public under a Final Public Report. Act 135, however, streamlined Chapter 514A's requirements for condominium marketing by eliminating the requirement that a developer market the units in a residential condominium project designated for owner-occupants be-

¹ As of December 1997, the Real Estate Commission was finalizing revisions to its condominium Public Report form to accommodate the new Contingent Final Public Reports, and expected to issue the revised form in early 1998.

fore issuance of a Public Report. Instead, Chapter 514A as amended by Act 135 now provides that the developer of a residential condominium project must market the owner-occupant units in a project after the Real Estate Commission has issued an effective date for the project's first Public Report.

Specifically, Act 135 amended Chapter 514A to provide that a developer must publish notice of the sale of units to prospective owner-occupants at least once in each of the two successive weeks following the issuance of the first Public Report on a project. See Haw. Rev. Stat. Sec. 514A-102(a). Chapter 514A then requires the developer to offer the designated units to prospective owner-occupants in one of two ways. First, the developer may offer the units to prospective owner-occupants for thirty days from the date of the first publication of the notice of the sale, in the chronological order in which the purchasers submit to the developer an executed sales contract, an earnest money deposit, and an executed affidavit affirming their intent to be owner-occupants. See Haw. Rev. Stat. Sec. 514A-104(a). Alternatively, Chapter 514A now provides that prospective owner-occupants may submit their names and an executed owner-occupant affidavit to the developer between the date of the first publication of the developer's notice and the fifth day following the last publication. The developer is then required to hold a lottery no later than the thirtieth day after the first publication of the developer's notice and to offer purchase contracts on the designated units to the prospective purchasers in the order in which they are selected at the lottery. See Haw. Rev. Stat. Sec. 514A-104(b).

Eliminating Chapter 514A's requirement that developers undertake an early, separate marketing effort directed only

at prospective owner-occupants should have several benefits. First, it should reduce marketing costs by allowing developers to market their projects in only one or two phases. Further, developers will now be able to market to both prospective owner-occupants and the general public during a project's initial marketing phase, which should allow early, more effective, test marketing of a project in order to determine market feasibility and fulfill lenders' presale requirements. Finally, as the legislature found in enacting Act 135, these reforms should also streamline and simplify what before 1997 was "from both a buyer's and developer's perspective, a very complex and confusing process." See 1997 Act 135, § 1(b)(2).

Conclusion

By streamlining Chapter 514A's statutory requirements for the marketing of residential condominiums and lowering some of Chapter 514A's hurdles to condominium development, Act 135 significantly eases some of the burdens of developing condominium housing. The legislature should thus be commended for responding to the difficulties that developers have experienced in the tough condominium development market of the mid-1990s. Credit should also go to the members of the private sector - particularly The Myers Corporation - who developed and supported this reform effort and to the Real Estate Commission and the Real Estate Commission staff for their strong support of these reforms.

**(Rick Kiefer is an attorney in the Honolulu office of Carlsmith Ball Wichman Case & Ichiki where he concentrates in real property transactions and development.)*

WHAT HAS YOUR BOARD BEEN UP TO?

The Board of Directors of the Real Property and Financial Services Section holds its meetings at the HSBA offices on the third Friday of each month. Members of the Section are welcome to attend. The following is a brief summary of Board Minutes for September, October and November (no meeting was held in August):

SEPTEMBER MEETING:

- David Callies asked if there was a way we could monitor bills during the next legislative session. Steve Okumura volunteered to monitor relevant bills and agreed to contact Nancy Grekin to see if there is a way we can use our Web Site to keep our membership informed of bills that might be of interest.
- Bud Quitiquit reported that a final judgment was issued in the Perfect Title matter. A copy of the judgment was given to Nancy Grekin to post on our Web Site.

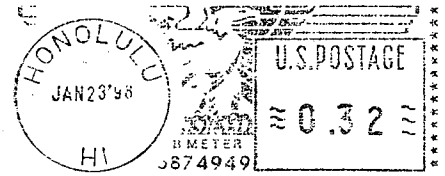
OCTOBER MEETING:

- David Callies reported that the Section Bylaws would be available at the annual Section meeting.
- Nancy Grekin is investigating the possibility of putting pending legislation on the Web Site while the legislature is in session. The Section Bylaws are also being put on the Web Site.

NOVEMBER MEETING:

- The Section will have its two regular annual seminars, the Legislative Update seminar in July, 1998 and the Litigation Update seminar in October, 1998. There was discussion concerning other possible seminars, including timeshare, condominium and resort, assisted living and registration and title matters. Other proposed topics discussed were foreclosures, land trusts, an update of the conveyance manual and mechanics' and tax liens.
- Because of the expansion of the Section newsletter and the resulting increased costs, it was voted unanimously to raise Section dues next year by \$10.00.

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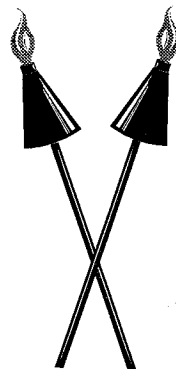
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CALENDAR OF EVENTS

Feb 20 Board of Directors' Meeting
12:00 HSBA Office

Mar 20 Board of Directors' Meeting
12:00 HSBA Office

Apr 17 Board of Directors' Meeting
12:00 HSBA Office

May 15 Board of Directors' Meeting
12:00 HSBA Office

Nov 30 - Hawaii State Bar Convention
Dec 1 Sheraton Waikiki Hotel