

EXECUTIVE SUMMARY

It is estimated that Japanese investments in Hawaii real estate totaled approximately \$15,000,000 during the period from 1985 to 1990, a time known as the "Japanese bubble." This influx of foreign capital led to artificially high land values, which were then used as comparables in rent renegotiations for commercial and industrial leasehold properties. Moreover, the presence of a "not less than" clause in many long-term ground leases resulted in lease rents remaining higher than they would have if the renegotiated rents had been based upon lower land values following the bursting of the Japanese bubble.

Several times since the early 1990s, the Hawaii Legislature has attempted to alleviate the perceived economic burden on lessees of commercial and industrial properties. Much of the legislative focus has been on the "not less than" clause contained in many of the leases. Proposed relief has ranged from legislation authorizing a one-time rent renegotiation overriding any "not less than" clause to bills that would effectively eliminate the clause altogether. However, as these legislative proposals would have the effect of altering various terms of existing lease agreements, the Attorney General has repeatedly concluded that such bills would violate the Contracts Clause of the United States Constitution.

The Attorney General has relied upon the test set forth by the Supreme Court of Hawaii to be applied in determining whether a state law is constitutional under the Contracts Clause. The Court outlined the three-step constitutional analysis as follows:

1. Whether the state law operated as a substantial impairment of a contractual relationship;
2. Whether the state law was designed to promote significant and legitimate public purpose; and
3. Whether the state law was a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose.

In considering bills introduced during the Regular Sessions of 2000, 2001, and 2002, respectively, the Attorney General concluded that a court could find that the measures ran afoul of the Contracts Clause because they did not appear to promote a significant and legitimate public purpose, nor did they appear to be a reasonable and narrowly drawn means of promoting the significant and legitimate public purpose, thereby failing the final two criteria of the constitutional analysis.

Subsequently, the Legislature adopted Senate Concurrent Resolution No. 89, S.D. 1, during the Regular Session of 2003, which requested the Bureau to study the major problems still facing commercial and other land lessees. In undertaking the study, the Bureau prepared and disseminated questionnaires to persons and organizations representing a broad spectrum of viewpoints, ranging from landowners or lessors who did not believe that a problem existed, to lessees who were urging a one-time rent renegotiation overriding any "not less than" clause in an

existing lease. Taking into consideration the responses to the questionnaires and the data collected, the Bureau observed, among other things, that one of the main problems cited by lessees was the presence of a "not less than" clause. However, the Bureau found that there was no indication, at the time of the report, of a broad-based compelling need for legislation altering existing lease agreements, which would be required to pass constitutional muster. Rather, the Bureau concluded that the primary problem facing lessees was the lack of available fee simple commercial and industrial property on the market. The Bureau also noted that the response rate for the questionnaires disseminated by the Bureau was very low, thereby making it unclear how much weight should be given to the responses received by the Bureau.

During the Regular Session of 2012, the Legislature adopted Senate Concurrent Resolution No. 90, S.D. 1, which requested the Bureau to update its 2003 report by incorporating an economic analysis to determine if there is a nexus between the existence of high lease rents in Hawaii and the stagnation of the State's economy. The resolution requested the Research and Economic Analysis Division of the Department of Business, Economic Development, and Tourism and the Economic Research Organization at the University of Hawaii at Manoa to conduct the economic analysis and transmit a draft report to the Bureau. However, as no funds were appropriated for the preparation of the requested economic analysis, both the Research and Economic Analysis Division and the Economic Research Organization were unable to provide the economic analysis due to lack of budgetary and personnel resources.

The Bureau has neither the personnel nor the expertise to undertake a definitive economic study. Therefore, this report will provide a review of previous efforts to address issues with high lease rents, the constitutional issues involved, and the possible impact of an economic analysis. Taking into consideration previous legislative action, relevant case law, and opinion letters drafted by the Attorney General, the Bureau concludes that if it is the Legislature's intent to alter existing lease agreements by overriding any "not less than" clause, the economic analysis contemplated by Senate Concurrent Resolution No. 90, S.D. 1, could potentially provide data to effectively address the constitutional concerns raised by the Attorney General. If it were to be determined that a nexus exists between the existence of high lease rents in Hawaii and the stagnation of the State's economy, a court could conceivably find that legislation overriding any "not less than" clause passes constitutional muster by virtue of advancing broad societal interests. Moreover, if the Legislature intends to pursue obtaining an economic analysis, it is advisable that a sufficient timetable and funding be provided for this purpose.