

ALAN M. ARAKAWA  
Mayor

BRIAN T. MOTO  
Corporation Counsel

DEPARTMENT OF THE CORPORATION COUNSEL  
COUNTY OF MAUI  
200 SOUTH HIGH STREET  
WAILUKU, MAUI, HAWAII 96793  
TELEPHONE: (808) 270-7740 FAX 270-7152

February 14, 2003

MEMORANDUM

MEMO TO: Honorable Alan M. Arakawa, Mayor

F R O M: Edward S. Kushi, Jr., Deputy Corporation Counsel

A handwritten signature in black ink, appearing to be "E. Kushi, Jr.", is written over the "F R O M:" line.

SUBJECT: **Lokahi Pacific; Hale Lokahi Elua; Promissory Note and Mortgage encumbering long term State of Hawaii lease.**

Pursuant to your request and our meeting with representatives of Lokahi Pacific ("Lokahi") on January 29, 2003, we have received and reviewed further documents from Lokahi, specifically the May 12, 1993 Promissory Note ("Note"), the Mortgage, Security Agreement and Financing Statement ("Mortgage"), and the State of Hawaii Department of Land and Natural Resources General Lease No. S-4195 ("Lease").

My understanding is that in or about 1993, Lokahi purchased the leasehold interest, at public auction, from the State, which at that time had 40 years remaining of its initial 65 year term.<sup>1</sup> The purchase price was \$400,000, with Lokahi putting up \$100,000. The balance was obtained from the County in the form of a "loan" for \$300,000, payable in annual principal installments of \$15,000 over 20 years, no interest being assessed (additional \$3,000 per year assessed as an "administrative fee"). The "loan" and obligation to repay were evidenced by the aforementioned Note and Mortgage. **Of critical significance and not yet determined are:** what revenue source this "loan" fund was taken from (*i.e.*, general revenues, grant revenues, general obligation bonds, revenue bonds, etc.); whether this loan and the expectation of repayment by the County is reflected in past and/or current annual budgets; whether the Board of Land and Natural Resources consented to the Mortgage in accordance with Section 171-22,

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<sup>1</sup>In 1994, the Lease was assigned by Lokahi Pacific to Hale Lokahi Elua, a Hawaii non-profit corporation.

Honorable Alan M. Arakawa  
February 14, 2003  
Page 2

Hawaii Revised Statutes, and paragraph 15 of the Lease; and whether Council approval by resolution was obtained.

As set forth in the January 21, 2003 letter to Director Alice Lee from Lokahi, the State, in its periodic lease-rent escalation review, has proposed an increase in the annual lease rent from \$6,700 to \$20,000 (300% increase), and thus, Lokahi is requesting the County's consideration to "forgive" the remaining balance owing on the Note (\$195,000 balance owing). Lokahi has represented that the "Bottom line is that this project cannot bear the annual loan and lease payments plus the cost of operations."

Debt Forgiveness:

Generally, for non-budget items/appropriations, the administration can and has in the past, "written-off" so called "uncollectable" debts due and owing the County, it being within the discretion of the administration to determine whether the time and effort to collect said debt would be fruitless. Please understand that the term "written off" or "write-off" is not a legal term, but an accounting term in the sense that one would report a "bad debt" on financial statements. We have reviewed all relevant charter and code provisions, and can find no prohibition regarding this practice, nor any requirement for Council approval. We do note, however, that past administrations have notified the Council prior to adjusting the relevant account(s).

However, for funds that have been specifically appropriated in the annual County budget, any material amendment to the character, nature, purpose, use and/or disposition of said funds may require Council approval, possibly via an ordinance.

Likewise, if the "loan" was approved and/or authorized by the Council in 1993 or prior thereto through an ordinance, or most likely, via resolution, any change should also be reviewed and approved by said body.

Although the loan is secured by the Mortgage (i.e., mortgage on the lessee's leasehold interest in the real property, or leasehold mortgage), which provides for remedies such as foreclosure and auction sale as well as rent collection pending sale in the event of default, we do not believe an event of default would mandate foreclosure and/or collection proceedings, as the Note itself, at page 2 under "Default", states:

"If I fail to make payments to you as stated above, you will have the option, .....to declare this Note to be in default, and then demand full payment of the remaining principal balance, plus interest, immediately." ....."(emphasis added)

Accordingly, depending on the historical background and procedure that was used to authorize this "loan", the "forgiveness" or "writing-off" of the remaining balance may be accomplished.

Alternatives:

1) Restructure the terms of the Note, by providing for lower annual payments to the County over a longer period, based on the fact that the original 1993 Note required 20 annual payments with 40 years remaining on the Lease term. County may also consider amending the terms of the Mortgage to allow Lokahi to rent to a higher income category, thereby securing more gross rental proceeds.

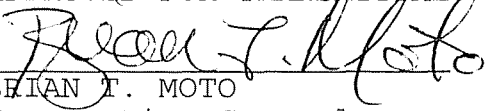
2) Formally convert the balance owing into a "grant-loan" as provided for in Section 3.36.170, Maui County Code, which would need approval by the Council. Repayment would be based on the ability to pay, and if deemed warranted, the entire amount may be waived by Council resolution pursuant to Section 3.36.170(D).

3) Subject to State approval, have Lokahi assign the Lease to the County, the consideration for which would be the remaining balance owing to the County. County would, subject to State approval, sublease the property to Lokahi to operate the facility with revenue going first to Lokahi for its approved expenses, second to satisfy State lease rent, and the balance, if any, as general revenue to the County.

4) A combination of the above.

Call if further clarification/discussion is needed. Please be advised that our response is subject to change upon receipt and review of the relevant information and documentation concerning the origin and approval of this "loan", which information and documentation should be obtained from/by the Department of Housing and Human Concerns.

APPROVED FOR TRANSMITTAL:

  
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BRIAN T. MOTO  
Corporation Counsel

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cc: Alice Lee, Director, Department of Housing & Human Concerns