

Hawaii Lending Law by Deborah Macer Chun

A GUIDE FOR COMMERCIAL LENDERS AND BUSINESSES

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<http://www.abanet.org/buslaw/committees/CL190000pub/surveys.shtml>

It is intended to provide a general outline of the laws of the State of Hawaii that govern commercial lending, commercial real estate finance and related areas. With limited exceptions, it does not address issues and laws related specifically to consumer financing.

By its nature, the guide is an overview only, and should not be relied upon with respect to any specific transaction without legal advice tailored to that transaction.

This guide was last revised in April 2004 and does not address the effect of changes since that time.

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BASIC LEGAL STRUCTURE

General Law

Hawai'i's general law is found in the Hawai'i Constitution, Hawai'i Revised Statutes, and common law. The common law is applied unless the matter is expressly covered by the United States Constitution, Hawai'i Constitution, Hawai'i Revised Statutes ("H.R.S."), local ordinances, administrative rules or federal law.

Common Law

Hawai'i follows the common law of England, as ascertained by English and American judicial decisions except as fixed by Hawaiian judicial precedent or by Hawaiian usage. Decisions by the Supreme Court of Hawai'i and the Hawai'i Intermediate Court of Appeals are binding law in Hawai'i. Decisions by the courts of other states or federal courts concerning state law have only persuasive effect in this State. Contracts, torts, and property are examples of areas largely governed by common law, although statutes have been adopted in some of these areas.

Statutory Law

Hawai'i statutory law is contained in Titles 1 through 38, Hawai'i Revised Statutes, and includes the following that may be of particular interest to commercial lenders and businesses:

- Title 5: State Financial Administration
- Title 14: Taxation
- Title 17: Motor and Other Vehicles
- Title 22: Banks and Financial Institutions
- Title 23: Corporations and Partnerships
- Title 23A: Other Business Entities
- Title 24: Insurance

- Title 25: Professions and Occupations
- Title 26: Trade Regulation and Practice
- Title 27: Uniform Commercial Code
- Title 28: Property

Procedural Law

With some exceptions, the Hawai'i Rules of Civil Procedure and the Rules of the Circuit Courts of the State of Hawai'i govern civil (non-criminal) matters in the Hawai'i Circuit Courts, and the District Court Rules of Civil Procedure and the Rules of the District Courts of the State of Hawai'i govern civil matters in the Hawai'i District Courts. The Hawai'i Rules of Appellate Procedure govern proceedings in the Hawai'i appellate courts except as provided by statute or the Rules of the Supreme Court. All procedural rules can be found in the Hawai'i Court Rules published by West Group.

Administrative Law

A number of Hawai'i state agencies have rule making and regulatory authority. These agencies include: the Hawai'i Department of Commerce and Consumer Affairs which regulates, among other things, financial institutions, mortgage brokers, and insurance companies; the Hawai'i Department of Business, Economic Development & Tourism; the Hawai'i Department of Taxation; the Hawai'i Department of Land and Natural Resources; and the Hawai'i Department of Transportation. Copies of the administrative rules and regulations can be found at the Supreme Court of Hawai'i Law Library or obtained directly from the agencies. They can also be accessed at the official State of Hawai'i Office of the Lieutenant Governor web site: <http://www.hawaii.gov/lsgov/office/adminrules/>, although the information at that site may not be current.



Local Law

Hawai'i has four counties: the City and County of Honolulu (covering the Island of O'ahu), County of Hawai'i (covering the Island of Hawai'i), County of Maui (covering the Islands of Maui, Lana'i, Moloka'i and Kaho'olawe), and the County of Kaua'i (covering the Islands of Kaua'i and Ni'ihau and the uninhabited Islands of Lehua and Ka'ula). Each has its own governmental authority which may pass its own ordinances.

Hawai'i Court System

The Hawai'i court system is divided into three main tiers: district courts including the small claims division, circuit courts, and the appellate courts which include the intermediate court of appeals and supreme court.

Hawai'i District Courts are courts of limited jurisdiction and do not handle jury trials. District Courts preside over civil matters where the amount in dispute does not exceed \$10,000, as well as criminal cases where the right to a jury trial does not exist or is not demanded, traffic infractions, summary possession and ejectment cases. Hawai'i District Courts share concurrent jurisdiction with Hawai'i Circuit Courts in non-jury cases where the relief sought is between \$10,000-\$20,000.

Hawai'i Circuit Courts are courts of general jurisdiction and preside over probate, guardianship, and civil cases where the relief sought exceeds \$20,000. All jury trials, claims for equitable relief and disputes involving title to real property are handled by the Hawai'i Circuit Courts.

The Hawai'i District Courts and the Hawai'i Circuit Courts are divided into the First Circuit, Second Circuit, Third Circuit, and Fifth Circuit (there is

no Fourth Circuit). The First Circuit's courthouse is in Honolulu, on the Island of Oahu. The Second Circuit's courthouse is in Wailuku, on the Island of Maui. The Third Circuit's courthouses are in Hilo and Kailua-Kona, on the Island of Hawai'i, and the Fifth Circuit's courthouse is in Lihue, on the Island of Kauai.

The Hawai'i Intermediate Court of Appeals (ICA) is the second highest court in the State. It has concurrent jurisdiction with and reviews cases assigned to it by the Supreme Court of Hawai'i, and reviews decisions of the District and Circuit courts, as well as administrative agencies. The ICA is located in Honolulu.

The Supreme Court of Hawai'i is the State's highest court, and its decisions are binding on all other Hawai'i courts. The Supreme Court of Hawai'i may review decisions of the ICA, District and Circuit courts, and administrative agencies and also has original jurisdiction over certain other matters. It is located in Honolulu.

There is one federal district court in Hawai'i, the United States District Court for the District of Hawai'i, which is located in Honolulu. The United States Bankruptcy Court for the District of Hawai'i is also in Honolulu.

AUTHORITY

Qualification to Do Business, Necessity, Procedure, Exemptions

Entities that are formed in jurisdictions other than Hawai'i must qualify under Hawai'i law to "transact business" in Hawai'i. A certificate of authority is obtained by filing with the Director of the Department of Commerce and Consumer Affairs. Under

Hawai'i law applicable to out-of-state corporations and limited liability companies, neither the creation nor the acquisition of indebtedness or mortgages or other security interests in real or personal property (either as borrower or lender) or the securing or collecting of debts or enforcing any rights in property securing the same are considered to be "transacting business" in the State. H.R.S. §414-431(a) (7) and (8) and §428-1003(b) (7) and (8). However, if a lender acquires the collateral, qualification to do business in Hawai'i may be necessary, depending upon the actions thereafter taken with respect to the collateral. For example, if the collateral acquired is leased property, such as an office building or shopping center, the lender will need to qualify to do business in Hawai'i in order to continue operating the building or center. An out-of-state entity that is not required to register to do business in Hawai'i may nevertheless sue or be sued in Hawai'i courts, *Benham v. World Airways, Inc.*, 253 F.Supp. 588 (D. Haw. 1966), and is also allowed to file a diversity action in the U.S. District Court, *Hinden/Owen/Engelke, Inc. v. Wailea Kai Charters*, 949 F.Supp. 775 (D. Haw. 1996).

Foreign Lender Law

Hawai'i's foreign lender law, found in Part II of Chapter 207 of the Hawai'i Revised Statutes, expressly exempts, from Hawai'i's business registration and taxation laws, specified out-of-state (or "foreign") lenders performing specified lending operations. (Note: The exemption provided in the statute does not mean engaging in the listed activities will necessarily require a lender to qualify to do business in the State; the primary benefit is the exemption from taxation.) A qualifying foreign

lender: (a) must not maintain a place of business in Hawai'i; and (b) must fit into one of the following "types" of lenders:

- a depository institution as defined in the federal Depository Institutions Deregulation and Monetary Control Act of 1980
- a real estate investment trust ("REIT") as defined in the Internal Revenue Code
- an insurance company
- trustees of any employee benefit plan
- a lender approved by the United States Department of Housing and Urban Development ("HUD") for participation in any mortgage insurance program under the National Housing Act
- any corporation that is wholly owned by one of the above types of lenders or that is a wholly owned subsidiary of a parent corporation that is wholly owned by one of the above types of lenders

However, the term "foreign lender" does not include any financial services loan company licensed under Article 9 of Chapter 412 of the Hawai'i Revised Statutes.

Foreign lenders are permitted to conduct the following activities without becoming subject to business registration requirements or taxation:

- make loans secured by real property in Hawai'i
- receive security for loans
- acquire loans or security in loans by assignment
- service (but only through persons who are residents of Hawai'i or entities transacting business in Hawai'i), collect, enforce loans and take, hold and dispose of any property acquired (whether by foreclosure sale, foreclosure under power of



sale, or conveyance in lieu of foreclosure) in the enforcement of the foreign lender's rights in the event of the borrower's default

- employ agents to perform all acts incident to the foregoing activities

Mortgage Brokers

Hawai'i law governing the activities and licensing of mortgage brokers and solicitors is contained in Chapter 454 of the Hawai'i Revised Statutes. The term "mortgage broker" is broadly defined and can be construed to apply to lenders who would not generally be considered a "mortgage broker" under the laws of other states. However, lenders who can qualify as a foreign lender under Chapter 207 (described above) are exempt from the licensing and other requirements of Chapter 454. The note and mortgage evidencing and securing a loan made by an unlicensed mortgage broker are void. *Beneficial Hawai'i, Inc. v. Kida*, 96 Hawai'i 289, 30 P.3d 895 (2001).

Collection Agents

A collection agent is defined under Hawai'i law as "any person, *whether located within or outside this state*, who by oneself or through others undertakes...to collect for another person, claims or money due on accounts or other forms of indebtedness for a commission, fixed fee or a portion of the sums so collected". H.R.S. §443B-1. No collection agency may collect or attempt to collect any money or other form of indebtedness from any person who resides or does business in Hawai'i without first registering under Hawai'i law. Registration requires the maintenance of a bond, the maintenance of a regular active business office in Hawai'i and the designation

of a principal collector. H.R.S. §443B-3.

Financial Services Loan Companies

While, as a general rule, non-Hawai'i based lenders are not required to be licensed in order to engage in lending activities in Hawai'i, a lender making consumer loans or home business loans (described in the discussion on Interest and Usury) in excess of the general usury limit of 12% must (absent an ability to export a greater rate) be licensed as a financial services loan company pursuant to Article 9 of Chapter 412 of the Hawai'i Revised Statutes.

Taxation

Whether income on loans made to Hawai'i customers is subject to Hawai'i income, franchise and general excise taxes (currently 4% of gross income) is not always clear. The Hawai'i taxing authority's view of the basis on which the Hawai'i income tax (Chapter 235, Hawai'i Revised Statutes) is imposed is very broad, including not only income from business carried on in Hawai'i but also income from sources in Hawai'i. With respect to Hawai'i's general excise tax (Chapter 237, Hawai'i Revised Statutes), the taxing authority has demonstrated a propensity, in certain situations, to reach very far in its definition of "transacting business" for purposes of taxing jurisdiction. However, it appears the risk of taxation may be reduced by negotiating the loan, conducting the closing, and holding the note and loan documents outside of the State, and by requiring that loan payments be made directly to a location outside of the State. Further, income on mortgage loans made by a lender qualifying as a foreign lender (described above) are exempt from taxation under Chapter 207 of the Hawai'i Revised Statutes.

FUNDAMENTALS

Basic Contract Law

Hawai'i contract law is based on the common law and is generally similar to that in other states. As in most other jurisdictions, Hawai'i has adopted the Uniform Commercial Code (UCC).

Promissory Notes

The Hawai'i laws applicable to commercial promissory notes are found in Article 3 of the Hawai'i UCC (H.R.S. §490:3-101, *et. seq.*), as well as Hawai'i common law. In addition, interest and usury are addressed in Chapter 478 of the Hawai'i Revised Statutes. Under Hawai'i law, a lender must communicate the exercise of its option to accelerate the maturity date of a note upon default, even though the note explicitly provides for acceleration "without notice." *Bank of Hawaii v. Kunimoto*, 91 Haw. 427, 984 P.2d 1253 (1997).

Statute of Frauds

The statute of frauds is codified in the UCC as well as Chapter 656 of the Hawai'i Revised Statutes. Generally, under the latter, the following contracts are not enforceable unless in writing and signed by the persons to be charged or by such persons' agent(s), who are authorized in writing to sign (H.R.S. §656-1): (1) a contract that is not to be performed within one year from its making, or (2) a contract to answer for the debt, default or misconduct of another. Hawai'i common law recognizes certain exceptions to the statute of frauds, such as where there is part performance or detrimental reliance.

INTEREST AND USURY

Commercial Lending Rate

Interest and usury are for the most part governed by Chapter 478 of the Hawai'i Revised Statutes. However, a lender that is a financial services loan company (FSLC), as that term is defined in H.R.S. §412: 9-100, may also be subject to interest rate limits set forth in Article 9 of Chapter 412 of the Hawai'i Revised Statutes.

Hawai'i does not impose any interest rate limits on commercial loans with two exceptions. First, the maximum rate that may be charged with respect to a credit card agreement, whether for consumer or commercial uses, is 18%. H.R.S. §478-4(a) and (b). Second, the maximum interest rate that may be charged on a "home business loan" is 24% for financial institutions regulated under Chapter 412 of the Hawai'i Revised Statutes and 12% for all other lenders (unless the lender can export a higher rate under federal law). H.R.S. §478-4(a) and (b). A "home business loan" is a credit transaction (1) in which the principal amount does not exceed \$250,000 or in which there is an expressed written commitment to extend credit in the principal amount not exceeding \$250,000; (2) which is not a consumer credit transaction; and (3) which is secured by a mortgage of the principal dwelling of any natural person who is a mortgagor named in the mortgage given as security in connection with the credit transaction. H.R.S. §478-1.

Post-Default Interest and Late Fees

There is no statutory limitation that would prevent an increase of the interest rate on a commercial loan upon default (other than for a home business



loan or credit card debt which are subject to the usury limits described above). However, under Hawai'i law, default rates, late fees, and other similar charges may be analyzed as liquidated damages and, consequently, either upheld as a valid provision for liquidated damages or struck down as a penalty. In re Holiday Mart, Inc., 9 B.R. 99 (Bankr. D. Hawai'i 1981).

Methods of Interest Assessment

Interest may be assessed on commercial purpose loans on any method contracted for under the loan documents. An FSLC lender is specifically authorized to charge, contract for and receive interest on loans on a precomputed basis or a simple interest basis. H.R.S. §412: 9-301. If a precomputed interest loan made by an FSLC lender is paid in advance, the borrower is entitled to a refund of the unearned interest calculated under a method no less favorable than the Rule of 78ths method (if the original term of the loan was 60 months or less) and equal to the difference between the interest originally charged and the actuarially earned amount (if the original term of the loan was greater than 60 months). However, the FSLC lender may retain at least \$15 of interest on such precomputed loan. H.R.S. §412: 9-306.

Interest Accrual

Hawai'i law does not restrict the accrual of interest on commercial purpose loans, provided that interest is accrued in accordance with the terms of the loan documents.

Points and Prepaid Fees

Points and other prepaid loan and commitment fees on commercial purpose loans are permitted in

Hawai'i and are not subject to refund or rebate if for some reason the loan is not closed or if the loan is prepaid in full prior to maturity. For a home business loan, however, the assessment of points and other prepaid fees that constitute finance charges will be included in the calculation of the maximum permissible interest rate. H.R.S. §478-4(b).

Additional Fees and Charges

Generally, there are no limitations to the amount of additional fees and charges that may be assessed in connection with commercial purpose loans, and such fees and charges are, for the most part, not subject to refund or rebate if the loan is not closed or if the loan is prepaid in full prior to maturity. However, while there are no specific limits, prepayment fees may be analyzed as liquidated damages similar to late fees as discussed above. Further, certain restrictions do apply to an FSLC lender.

Attorney's Fees

Pursuant to H.R.S. §607-14, in all actions in the nature of assumpsit and in all actions on a promissory note or other contract that provides for the same, attorney's fees of up to 25% of the amount in dispute may be received.

CONFLICT OF LAWS RULES

Choice of Law Covenants—General Rule

The Hawai'i Supreme Court has held—with respect to contracts generally—that when the parties choose the law of a particular state to govern their contractual relationship and the chosen law has some nexus with the parties or the contract, that law will generally be applied so as to protect the justified expectations of the parties. *Airgo, Inc. v. Ho-*

rizon Cargo Transport, Inc., 66 Haw. 590, 670 P.2d 1277, 1281 (1983), citing Restatement (Second) Conflict of Laws (the "Restatement") §187 (1) (1971); *Hawaiian Telephone Co. v. Microform Data Systems, Inc.*, 829 F.2d 919, 922 (9th Cir. 1987); *Brown v. KFC Nat'l Mgmt. Co.*, 82 Haw. 226, 921 P.2d 146, 153 (1996). Similarly, the Hawai'i UCC provides generally that the parties to a transaction can agree that the law of a particular state shall govern their rights and duties where the transaction bears a reasonable relationship to that state. H.R.S. §490:1-301.

Exceptions

There are several exceptions to the general rule regarding the enforceability of a choice of law provision. First, real property is exclusively subject to the law of the state within which it is situated, and, therefore, "all matters concerning taxation of such realty, title, alienation, and the transfer of such realty and the validity, effect, and construction which is to be accorded agreements intending to convey or otherwise deal with such realty are determined by the doctrine of *lex loci rei sitae*, that is, the law of the place where the land is located." *In re Grayco Land Escrow, Ltd.*, 57 Haw. 436, 450, 559 P.2d 264 (1977). Thus, matters such as the method of perfection/recordation of a security interest, the effects of the failure to perfect or record, foreclosure and collateral protection provisions, will be governed by the law of the situs of the property.

Second, the Hawai'i UCC mandates the application of the law of a certain state to determine perfection, the effect of perfection or nonperfection, and the priority of a security interest in certain collateral. H.R.S. §490:1-301(c).

Third, the Restatement (Second) of Conflicts of Law provides that an otherwise effective choice-of-law provision in a contract will not be given effect if the "application of the law of the chosen state would be contrary to a fundamental policy of a state which has materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of Section 188 [(relating to most significant contacts)], would be the state of applicable law in the absence of an effective choice of law by the parties." Restatement (Second) of Conflicts of Law §187 (2)(b)(1971). *See also* Restatement (Second) of Conflicts of Law §203, comments e and f (applying this rule in modified form to usury laws). Hawai'i courts look to the Restatement for guidance regarding conflict of laws. *UIARCO Inc. v. Lam*, 18 F. Supp.2d 1116 (D. Haw. 1998); *California Federal Svs & Loan v. Bell*, 6 Haw. App. 597 (1987).

There are no reported Hawai'i cases addressing what constitutes a fundamental policy of this State in the context of a loan in which the parties included a choice-of-law provision. However, in addressing the permissibility of a deficiency judgment in the context of a foreclosure of an agreement of sale which apparently had no choice-of-law provision and which the Court acknowledged had a significant relationship to California, the Hawai'i Supreme Court held that Hawai'i law would apply because, while "California's interest in protecting its citizens against deficiency judgments... is of extreme importance to it... [o]f equal, if not greater, importance... are considerations regarding predictability of results in disputes over transactions involving land in this jurisdiction, maintenance of interstate order, and



this state's governmental interest in upholding its law relating to real estate transactions." *California, infra at 606*. Given this ruling, it would not be surprising if the Hawai'i Supreme Court found the "fundamental policy" exception applied to matters relating to foreclosure or the enforcement of security documents even though those matters do not affect an interest in the land.

Standardized Contracts

Many out-of-state businesses and lenders opt to use standardized multi-state contract and security agreement forms when entering into transactions with Hawai'i customers. These contracts traditionally include choice of law covenants adopting the substantive laws of other states. Although it is acceptable to use such standardized multi-state contract forms in many instances, there are certain differences in Hawai'i law that mandate the use of special "Hawai'i addenda" to such standard form contracts. Additionally, Hawai'i specific forms may be required, such as the D-37 (to be assured of priority over tax liens on personal property).

TYPES OF BORROWERS

Corporations

Hawai'i corporations are subject to the Hawai'i Business Corporation Act (H.R.S. §414-1, *et seq.*), that is derived from the 1984 version of the Model Business Corporation Act. Chapter 415A of the Hawai'i Revised Statutes is applicable to professional corporations. The procedures under which foreign corporations may qualify to do business in Hawai'i are governed by H.R.S. §414-110. It is advisable to obtain a certificate of good standing from the Director of the Department of Commerce and

Consumer Affairs and appropriate resolutions from the corporation's board of directors when making a loan to a corporate borrower.

Partnerships

There are three types of partnerships recognized in Hawai'i: (1) general partnerships (subject to H.R.S. §425-1 *et seq.*); (2) limited partnerships (subject to Chapter 425E); and (3) registered limited liability partnerships (subject to H.R.S. §§425-151 to 425-173). The procedures under which foreign general and limited partnerships may qualify to do business in Hawai'i are respectively governed by H.R.S. §425-3 and Article 9 of Chapter 425E of the Hawai'i Revised Statutes. It is advisable to obtain a certificate of good standing from the Department of Commerce and Consumer Affairs and appropriate authorizations from the partners when making a loan to a partnership borrower. Each partner in a general partnership, as well as each general partner in a limited partnership, is jointly and severally liable for partnership debts and other matters chargeable to the partnership.

Limited Liability Companies

Hawai'i authorizes the formation of limited liability companies (LLCs). An LLC is a hybrid between a partnership and a corporation, having many of the attributes of both. An LLC may be taxed like a partnership, while providing limited liability to its members (or owners) making it similar to a corporation. Hawai'i LLCs are subject to the Hawai'i Limited Liability Company Act (H.R.S. §428-101, *et seq.*) which is derived from the 1994 version of the Uniform Limited Liability Company Act. The procedures under which foreign limited liability

companies may qualify to do business in Hawai'i are governed by H.R.S. §428-1002. When making a loan to a Hawai'i LLC, it is advisable to obtain a certificate of good standing from the Department of Commerce and Consumer Affairs as well as a certified copy of the LLC's Articles of Organization. It is also necessary to obtain and review the LLC's operating agreement (if any) in order to ascertain whether an appropriate resolution signed by the members (owners) of the company should be obtained. The individual members (owners) of an LLC are not liable for company debts and obligations unless a provision to that effect is contained in the company's Articles of Organization and the member so liable has consented in writing to be bound by such provision. H.R.S. §428-303.

Proprietorships and Individuals

Loans to proprietorships are treated in the same manner as loans to the individual owners of the business. Trade names may be registered with the Director of the Department of Commerce and Consumer Affairs. H.R.S. §482-2. Registration serves as constructive notice to all persons of the registrant's claim to the use of the trade name throughout the State, but does not abrogate or limit any common law or other right of any person to a name.

Married Persons

Under Hawai'i law, a married person can: (1) enter into contracts, and (2) receive, hold and dispose of real and personal property, all in the same manner as if he or she was an unmarried person. H.R.S. §§572-22 and 572-25. Upon marriage, the real and personal property of a spouse remains his or

her separate property, free and clear of control, debts and obligations of the other spouse. Previously, Hawai'i laws did impose certain restrictions on a married person's ability to dispose of property based on dower, curtesy, and community property. However, through the years, dower, curtesy and community property rights have either been restricted or abolished, to the extent that the likelihood that a property will be impacted by such rights is not very great. A decedent's surviving spouse or reciprocal beneficiary and children are entitled to a homestead allowance, exempt property and a family allowance. H.R.S. §560:2-402 specifies a homestead allowance of \$15,000 that is exempt from and has priority over all claims against the decedent's estate. Personal property not exceeding \$10,000 is deemed exempt property. H.R.S. §560:2-403. A family allowance in a reasonable amount for the support of the deceased's dependents during probate administration. H.R.S. §560:2-404.

Property Exempt from Claims of General Creditors

In Hawai'i, certain assets are exempt from seizure to satisfy the claims of general unsecured creditors. These include, by way of example, up to \$30,000 in equity in the family home (H.R.S. §651-92, *et seq.*); furniture and personal household items with a value not exceeding \$1,000; a motor vehicle with a value not exceeding \$2,575; tools of the trade; and the proceeds of insurance on the exempt property and wages (for the prior month's wages). H.R.S. §651-121, *et seq.*



REAL ESTATE LENDING

Property Rights

Property rights in Hawai'i are subject to the chapters contained in Title 28 of the Hawai'i Revised Statutes.

Recording Systems

Hawai'i has two real property recording systems. Property that has been submitted to the jurisdiction of the Land Court of the State of Hawai'i (a Torrens system) is commonly referred to as "land court property". All other property not registered under the land court system is referred to as "regular system" property. Any documents related to land court property are filed with the Assistant Registrar of the Land Court of the State of Hawai'i. Documents related to regular system property are recorded with the Bureau of Conveyances of the State of Hawai'i. (In actual fact, the Bureau of Conveyances and the Assistant Registrar's office are one and the same office although separate records are maintained.) A determination can be made as to which system is applicable by review of the property legal description. The land court property will contain a reference to a lot, a land court application or a land court consolidation number, and a certificate of title or transfer certificate of title. The regular system property will generally be described by metes and bounds, although it may also be described as a lot number by reference to a file plan.

Tenants by the Entirety

Property held by two individuals as tenants by the entirety may not be used to satisfy the sole debt of one person without the consent of the other. Thus, to effectively encumber property held as tenants by the entirety, both title holders must execute the mortgage.

In Hawai'i, property may be held as tenants by the entirety, not only by spouses, but also by two individuals who have entered into a reciprocal beneficiary relationship and registered that relationship with the State, as provided in Chapter 572C of the Hawai'i Revised Statutes.

Leases

Hawai'i is somewhat unique because of the large number of leasehold properties, both commercial and residential. An important step in the making of any loan secured by leasehold property is the review of the underlying lease including the insurance, casualty and condemnation provisions that may differ from, and take precedence over, the corresponding mortgage provisions. Additionally, consents, estoppels and other mortgage protection agreements may be required or appropriate.

Leases in Hawai'i are subject to several chapters of the Hawai'i Revised Statutes, depending on whether the lease is for residential or commercial/agricultural purposes, and whether the lease is for space in a building or the land itself. Chapters 516, 516D, 518, 519, and 521 of the Hawai'i Revised Statutes. Leases of real estate owned by the State of Hawai'i, including Hawaiian home lands, and lands under the direction of the board of trustees of the Office of Hawaiian Affairs, are subject to special laws governing the leasing of such lands.

Leases of land court property for a term of one year or more must be recorded. H.R.S. §501-121.

Mortgages

Real estate mortgages in Hawai'i are subject to Chapter 506 of the Hawai'i Revised Statutes and certain provisions of Article 9 of the Hawai'i UCC

with respect to fixtures on land. Hawai'i is a lien theory State that utilizes mortgages rather than deeds of trust. Under Hawai'i law, every transfer of an interest in real property that is made as security or subject to defeasance upon the payment of an obligation is deemed to be a mortgage, regardless of what it is called. H.R.S. §506-1(a).

Formalities of Mortgages

In order to be valid, enforceable and recordable, a Hawai'i real estate mortgage must satisfy the following requirements:

- the mortgage must be in writing
- the mortgage must be signed by the mortgagor
- the first page of the mortgage (which may be a fly sheet) must comply with very specific requirements:
 - the top 3 1/2 inches must be reserved for recording information for the assistant registrar on the left side and the registrar of conveyances on the right side
 - the following 1 inch is reserved for information showing to whom the document should be returned, and such information may begin 1 1/2 inches from the left margin and not exceed 3 1/2 inches per line
 - if possible, the names of the mortgagor and mortgagee, the address of the mortgagee, the type of document and the tax map key numbers of the affected property must be included on the first page; if the information will not fit on the first page, it must nevertheless be included in the document
 - only single sided sheets of paper, not exceeding 8 1/2 x 11 inches, may be used
- if the document contains more than 1 page, it may be stapled once in the upper left corner
- it must be legible
- the mortgagor's name in the mortgage must be identical to the name stated in the conveyance document from which the mortgagor derived its property interest and, if land court property is affected, a person's full name (no initials) must be used
- if the mortgagor is an individual, the mortgagor's marital status and, if married, the name of the spouse, must be included; if the mortgagor is a business entity, the state of its business organization must be included
- the name of the signatory, and the capacity of any person signing for an entity, must be typed beneath the signature line (not printed by hand)
- the mortgage must be notarized
- if there are any interlineations or erasures or changes in the document, they must be initialed by all of the notaries (if the document is signed in Hawai'i) or by all of the parties to the instrument or all of the notaries (if the document is signed outside of Hawai'i)
- if the mortgagee is an entity, there must be an attorney's opinion on file at the Bureau of Conveyances stating that the entity is validly existing and in good standing under the laws of the state or country of its organization; alternatively, a certificate of good standing from the state of organization may be submitted
- any mortgage being recorded in the land court system must make reference to the applicable Certificate of Title or Transfer Certificate of Title



Future Advances and Priority

If it so provides, a mortgage may secure future advances even if the lender is not under a contractual obligation to make the advance. H.R.S. §506-1(b). However, the statutory provision has been somewhat limited by case law so that the only future advances that are secured are: (a) those that are related to the initial mortgage loan or property, (b) those specifically referenced in the mortgage, and (c) those that the borrower subsequently agrees in writing are, in fact, to be secured by the prior mortgage. *Akamine & Sons, Ltd. v. American Security Bank*, 50 Haw. 304, 440 P.2d 262 (1968), *Haw. Nat'l Bank v. Okino*, 51 Haw. 367, 461 P.2d 136 (1969), and *Kamaole Resort Twenty-One v. Ficke Haw'n Investments, Inc.*, 60 Haw. 413, 594 P.2d 104 (1979). All future advances, up to but not exceeding the maximum amount of future advances stated in the mortgage, will have priority over any subsequently recorded lien except a lien for real property taxes and assessments for public improvements (which will be prior to the mortgage as well), regardless of whether the advances are obligatory. If the principal amount of a loan (or the maximum amount of advances under a loan) is increased by way of amendment, the priority of the mortgage lien, as to the amount of the increase in the loan or credit limit, will be determined as of the date an amendment to the mortgage setting forth that increase is recorded.

Construction Mortgage

A mortgage recorded prior to visible commencement of the improvements will take priority over mechanic's liens related to the improvements, even if the proceeds of the loan secured by the mortgage are disbursed after the visible commencement, without regard to whether the disbursements are

obligatory. If the mortgage is recorded after visible commencement has occurred but before completion of construction and if the mortgage recites that the purpose is to secure a loan to be advanced for the purpose of paying for the improvement in whole or in part, then the mortgage will have priority to the extent of the proceeds advanced for paying for the improvement. H.R.S. §507-46.

Recordation

A mortgage of regular system property, if not recorded, is void as against any subsequent purchaser, lessee or mortgagee who, in good faith, for consideration and not having actual knowledge of the mortgage, acquires an interest in the property. H.R.S. §502-83. An unrecorded mortgage of land court property will operate only as a contract between the parties and will not be operative to affect the land or (in most cases) be effective against third parties, even if the third parties have knowledge of the mortgage. H.R.S. §501-101.

The fee for recordation of a mortgage is \$25.00 plus one dollar per page exceeding twenty pages, payable to the Bureau of Conveyances.

Special Mortgage Recording Fee

In addition to the standard recording fees, H.R.S. §431P-16(b) provides for a special mortgage recording fee in an amount equal to one-tenth of one percent of the stated principal amount of the debt secured by the mortgage or, in the case of an amendment or refinancing of a mortgage, an amount equal to one-tenth of one percent of the increase (if any) of the stated principal amount of the secured debt. However, by Act 193 (2001 Regular Session), the special mortgage recording fee was suspended as of

July 1, 2001, and is to remain suspended until reactivated by the Board of the Hurricane Relief Fund.

Damage to Mortgaged Property

Under Hawai'i law, if residential real property is damaged or destroyed, the rate of interest on the loan secured by that property may not be increased. Further, notwithstanding any terms to the contrary in a mortgage, the borrower (and not the lender) has the option of applying insurance proceeds from the destruction of the residential mortgaged property either to restore the property or to pay down the debt. H.R.S. §506-7. There are no statutory definitions and no case law to clarify whether a "mortgage of residential real property" includes, for example, a mortgage of an apartment building or unit owned and leased by an investor as opposed to an owner-occupant.

Insurance Requirements and Limitations

There are no legal limits on the amount or type of insurance that a lender can require a borrower to carry on property serving as collateral for a loan. However, if the lender solicits the insurance on real and personal property securing the loan, the lender must give written notice to the borrower that the lender may not condition a loan upon the borrower obtaining the insurance from a specified company. A notice which satisfies truth-in-lending requirements will satisfy the notice requirements under this statute, although it should be noted that the notice requirements apply regardless of whether the transaction is a consumer transaction. H.R.S. §431:13-104(c). Additionally, a lender may not:

- Require the borrower to obtain the insurance through a particular insurer, broker or agent.

- Solicit insurance after a person indicates an interest in obtaining a loan until such person has received a commitment in writing from the lender as to a loan.
- Unreasonably reject a contract of insurance provided by the borrower.
- Require the borrower, insurer, broker or agent to pay a separate charge in connection with the handling of any insurance contract required in connection with the loan or pay a separate charge to substitute the insurance policy of the insurer for that of another.
- Use or disclose information relative to a contract of required insurance for the purpose of replacing such insurance or soliciting insurance.
- Require any procedures or conditions of agents, brokers or insurers not required of agents, brokers or insurers affiliated with the lender.

A lender may, however, place insurance if the borrower has failed to provide the insurance required by the loan agreement and may also assist a borrower in obtaining homeowner's insurance where the borrower requests the assistance in writing.

Cancellation of Mortgages

Upon full payment of the debt secured and satisfaction of the mortgage, the mortgagee is obligated to provide to the mortgagor a release of mortgage in recordable form. H.R.S. §506-8. If a mortgagee fails to provide the release within 60 days after a written request sent via registered or certified mail by any party in interest, the party in interest may initiate an action in any circuit court to obtain the release. If the plaintiff prevails, it may be awarded treble damages and attorney's fees and costs. Alterna-



tively, any title insurer that has obtained an affidavit setting forth proof that reasonably establishes that the debt has been paid may execute a release of the mortgage on behalf of the mortgagee. If the debt was not paid, and the title company was grossly negligent in executing the release, it will be liable to that mortgagee for treble damages and attorney's fees and costs.

Assignment of Mortgages

An assignment of a mortgage of land court property takes effect on the title of the mortgaged property only from the time of recordation. H.R.S. §501-116. Otherwise, the assignment will operate as a contract only between the assignor and assignee. If an assignment of a mortgage of regular system property is not recorded, the assignment will not bind parties without notice of the assignment.

Default and Foreclosure Remedies

Hawai'i law provides for judicial foreclosures and two different methods of nonjudicial foreclosures. (Chapter 667 of the Hawai'i Revised Statutes) Additionally, under the Hawai'i UCC, self-help remedies are available, but lenders need to be careful to avoid a "breach of the peace" in exercising such rights.

Judicial Foreclosure

A lender exercising a right to foreclose by judicial action is required to join all prior and subsequent mortgage creditors whose names are or can be discovered by the lender. Accordingly, prior to commencement of the foreclosure action, it is necessary for the foreclosing lender to obtain a title report (called a litigation guaranty) for the prop-

erty to ascertain the names of all mortgage lenders as well as other parties that may claim an interest in the property that the lender wants to foreclose. A judicial foreclosure can take anywhere from six months to more than a year, depending upon how strongly it is contested. A lender proceeding by judicial foreclosure may obtain a deficiency judgment against the borrower.

Power of Sale Foreclosure

Hawai'i has two different power of sale statutes. The older statute (in Part I of Chapter 667) is not particularly well-drafted and, as a result, title companies have been hesitant, if not unwilling, to issue title insurance after a power of sale foreclosure of a commercial loan under that statute. As a result, foreclosures were historically accomplished primarily by way of judicial foreclosure. Presently, more title companies are willing to issue insurance after foreclosure of a consumer loan, provided certain procedures are followed even though not required by the statute (including the waiver of any deficiency judgment) and provided there are no complicated title or lien issues.

The more recent statute (Part II of Chapter 667) is, from a lender's standpoint, even worse and has not been utilized much, if at all. Among other issues, it only applies to mortgages executed after July 1, 1999, the borrower must have been given certain "informational materials to educate and inform borrowers" at the time of the loan application (although there is no guidance or "safe harbor" as to the required language or content of the informational materials), the borrower must execute the conveyance document after foreclosure, and no

deficiency is permitted unless the debt is secured by other collateral.

Receivers

Receivers can generally be obtained in a judicial foreclosure action although, contrary to the stated provisions in most mortgages, absent extraordinary circumstances, the court will not allow a receiver to be appointed upon an ex-parte motion of the lender, but will, instead, require notice and a hearing. Receivers are generally not required to post bond.

Redemption

Hawai'i law does not provide redemption rights for borrowers after a mortgage foreclosure.

Request for Notice of Foreclosure

If a mortgagee wishes to have notice that another mortgagee of the same property intends to foreclose the mortgage pursuant to a power of sale (as opposed to a judicial foreclosure), he may submit a written request to the mortgagee foreclosing or who may foreclose the mortgage by power of sale to receive notice of the mortgagee's intention to foreclose. The request must be given to the foreclosing mortgagee prior to completion of its publication of notice of the foreclosure sale. The request must be signed by the mortgage creditor or its authorized representative which desires to receive notice, specifying the name and address of the person to whom the notice is to be mailed. The mortgagee who has received the request must give notice to all mortgagees who have timely submitted their request, and the notice must be sent by mail or otherwise communicated to the mortgage credi-

tors not less than 7 calendar days prior to the day of the sale. H.R.S. §667-6.

Lien Searches/Title Insurance

When making a mortgage loan in Hawai'i, title and lien searches are obtained with respect to the property and the borrower. Title insurance is available and written through licensed title agencies.

Title Insurance Endorsements

The title policy endorsements that are obtained for loans made in Hawai'i are generally the same as those obtained for loans made elsewhere. Several endorsements particular to Hawai'i are as follows:

- There is often a reservation of mineral and metallic mines in favor of the State as an exception to title. Title companies will usually issue an endorsement insuring the lender against any loss resulting from the exercise of that reservation. The form of endorsement is referred to as a "mineral and metallic mines" endorsement.
- Subject to a review of the property, the history of the property and other guidelines, an endorsement addressing a reservation of the rights of native tenants may be obtained.

Escrow

There are a number of title companies in Hawai'i, most of which provide escrow services either within the same company or through an affiliated escrow closing services company. Typically, local lenders will require the borrower to sign loan documents at the lender's office and will then forward the documents to escrow for recordation, conditioned upon the title company agreeing to provide insurance insuring the intended priority of the mortgage.



Most out-of-state lenders require the borrowers to sign and return documents to the lender, who then forwards to escrow those documents which need to be recorded, with the applicable escrow instructions. "New York style" closings are not typically used in Hawai'i.

PERSONAL PROPERTY LENDING

UCC Article 9

Hawai'i enacted, without any substantial modifications, the revised UCC Article 9 (RA9).

Priority of Tax Liens

Pursuant to H.R.S. §231-33, taxes due to the State of Hawai'i constitute a lien on all property prior to the rights of all other persons, subject to certain exceptions. As to real property, a tax lien is not valid against a mortgagee whose interest arises prior to recordation in the Bureau of Conveyances by the Department of Taxation of a certificate setting forth the amount of unpaid taxes. It is not necessary that Form D-37 (described below) be filed with respect to real property security. As to personal property, a secured party who gives notice to the Department of Taxation, on Form D-37 (prescribed by the Department of Taxation), of the security interest made or about to be made, takes free and clear of all taxes except those set forth in a certificate filed by the Department of Taxation within fifteen days after the Department's receipt of Form D-37. To be protected from all taxes other than those set forth in the certificate, the interest of the pledgee in the property must arise prior to, or within ten days after, the date the Department of Taxation files its certificate.

Mortgage as Financing Statement

Under the Hawai'i UCC, a mortgage may also serve as a financing statement for goods which are or are to become fixtures if it recites, in the caption, that it is a financing statement and otherwise meets the requirements for a financing statement. H.R.S. §490:9-502. A security interest in fixtures perfected in this manner need not be renewed every five years and remains effective until the mortgage is released. H.R.S. §490:9-515(g).

UCC Filing Rules

Unlike most states, Hawai'i has only one state-wide location for the filing of financing statements, which is the Bureau of Conveyances. H.R.S. §490:9-501. Filings are not made with a Secretary of State (there is none) nor with individual counties.

Motor Vehicles

A security interest in a motor vehicle required to be registered under Chapter 286 of the Hawai'i Revised Statutes (that is, every vehicle that is self-propelled and every vehicle propelled by electric power but which is not operated on rails and excluding mopeds) and which is not inventory can only be perfected by registration under Chapter 286. H.R.S. §490:9-311(a)(2).

UCC-1 financing statements affecting motor vehicle inventory are treated in the same manner as filings made with respect to other types of UCC collateral.

Fixture Filings

Fixture filings are made in the same manner as ordinary UCC-1 filings; however, there is currently a conflict between the requirements of the UCC for a fixture filing with respect to fixtures located on

Land Court property, the practical result being that a fixture filing will be accepted for filing in the Land Court system only if it is part of a mortgage.

UCC Lien Searches

The Hawai'i UCC provides that lenders may request the filing offices to provide a UCC search for a particular debtor. H.R.S. §490:9-523(b).

Filing and Other Fees

The basic fee for filing a UCC-1 financing statement and a termination statement is \$25.00 plus \$1.00 for each page in excess of 20.

EQUIPMENT LEASING

Hawai'i has enacted, without any substantial modification, Article 2A of the UCC.

OTHER LAWS OF INTEREST

Native Hawaiian Rights

The Hawai'i Supreme Court, in *Public Access Shoreline Hawai'i v. Hawai'i County Planning Commission*, 79 Haw. 425, 903 P.2d 1246 (1995), held that traditional and customary Hawaiian rights to enter on and use otherwise private property are protected by the Hawai'i Constitution and Hawai'i Statutes. Many issues and questions raised by the opinion are still being answered, including what exactly constitutes "traditional and customary practices," who can exercise the rights (i.e., whether the person must have some native Hawaiian blood), and the balancing of the competing rights of the landowner and those exercising the native rights.

Roll-Back Taxes

The real property tax laws provide for "roll-back"

tax impositions where real property previously assessed as agricultural is urbanized, subdivided or developed at a higher density. H.R.S. §246-10(f) (3). If applicable, a title report for the property should note the potential for such taxes.

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