

SAVIO

SAVIO REALTY LTD

August 8, 2018

RE: WAIKIKI BANYAN LEASED FEE SALES PROGRAM

Dear Lessee:

By now, you should have heard about the lease-to-fee conversion at Waikiki Banyan. Your lessor, Lili'uokalani Trust ("Seller"), has decided to reoffer the leased fee interest for sale to lessees. As discussed at the informational meeting, unlike previous offerings, after the Acceptance Deadline on November 27, 2018, Seller intends to make the unsold (uncontracted for) leased fees available for sale to 3rd party investors at the same prices as those being offered to the respective lessees. If a leased fee is sold to a 3rd party investor, the buyer, not the Seller, will determine whether to it wants to sell the leased fee to the lessee or another 3rd party or to keep it until the lease expires. (See Question 20 in the Questions and Answer Summary).

At the informational meeting, one of the most prevalent questions involved valuation and how the prices were determined. Some of the lessees at the meeting felt that the prices were too high and/or thought they would not be able to afford the purchase price. The suggestion given to those lessees in attendance was to initially focus less on the price and more on whether or not to purchase the leased-fee interest. Some lessees may not have sufficient equity in the leasehold unit to be able to purchase; others have purchased their unit some time ago and have sufficient equity. Lessees who have the ability to purchase should seriously consider doing so for the number of reasons covered below and in the question and answer summary. Lessees who do not have the ability to purchase should consider options other than doing nothing.

In making this decision whether or not to purchase, it was suggested that lessees consider all the costs of either converting to fee-simple ownership or remaining leasehold. The cost to convert to fee-simple ownership is the monthly payment you will have to make on a loan (See Questions 51 and 52 in the Questions and Answer Summary) or the interest you were receiving if you had cash in a savings account that you used for the purchase.

The cost to remain leasehold is less obvious. Many lessees look only at the direct cost of remaining leasehold, which is the lease rent they pay. There are, however, other hidden costs that most lessees do not take into consideration when making this most important decision. Briefly, these hidden costs are as follows (See Question 54 in the question and answer summary for a more detailed discussion):

1. Your lease rent will renegotiate again on December 1, 2020 and the amount of lease rent will likely increase.
2. The surrender clause in your lease requires you to give your unit back to your lessor at the end of the lease. Value is transferring to the lessor over time. As an example, if your leasehold unit is worth \$290,000 and there are 17 years remaining on your lease, you are losing \$17,059 each year (\$1,422 each month) and your lessor is gaining \$17,059 each year.

3. There is an opportunity cost of not being fee simple. As an example, if your fee simple unit is worth \$565,000 today and it appreciates as little as 3% each year, the opportunity cost in the first year is \$16,950 (\$1,412 in the first month). The opportunity cost goes up even more each year and significantly more if the appreciation each year is more than 3%.
4. Interest rates are still relatively low, but many economists and politicians are predicting that interest rates will continue to increase as the economy continues its recovery, some saying as high as 5½% in early fall and 6% by the end of the year. While no one knows how much interest rates will increase, I continue to believe it is safe to say that interest rates will be higher and perhaps significantly higher, next year.. The difference in the interest you pay over a 30 year loan could be in the tens of thousands of dollars (\$10,000s) with just a ¼% increase in rates.

When you take into consideration not only the direct costs of converting to fee-simple ownership, but also the hidden costs of remaining leasehold, it could cost you less to convert to fee simple. In summary, using the example above, the cost of purchasing the leased-fee interest was:

Between \$942.06 and \$970.30 per month depending on the interest rate used

The cost of remaining leasehold using the examples above would be:

Current monthly lease rent - \$168.06
 Lease rent on rent renegotiation - \$?????
 Surrender of leasehold unit at the end of the leased - \$1,422
 Opportunity cost of not being fee simple - \$1,412

Nonetheless, some lessees still may not be able to purchase because they either do not have sufficient equity in the unit or just do not want to purchase. Whatever the reason for not purchasing, this important decision should be made after taking into consideration all the future costs, both direct and hidden, that will affect your decision in the future.

Instead of just not purchasing the leased-fee interest and remaining leasehold, you might want to consider selling your leasehold unit now while you have more equity in the unit and purchasing another property, possibly a fee simple property. Another alternative may be to have your children or your parents purchase the leased-fee interest, especially if you were going to give the unit to them when you pass away. The same would pertain if you were going to give the unit to a charity when you pass away as the charity may prefer to purchase the leased-fee interest so that it would own a fee simple unit in the future.

We thought it would be important to share with each of you this background and why the Seller have chosen to offer the leased fees. In addition, a number of unit owners and Realtors have asked the Seller to make another offering of the leased fees.

We think it is important for you to consider purchasing now for the following reasons:

1. 766 Units (92% of the leased fees offered excluding 45 timeshare units) at Waikiki Banyan have converted to fee-simple ownership (although many are still subject to a sandwich lease).
2. 415 Units (95%) at Waikiki Sunset have converted to fee-simple ownership.

3. 367 Units (95%) at Liliuokalani Gardens at Waikiki have converted to fee-simple ownership.
4. 97 units (73%) at Foster Tower have converted to fee-simple ownership.
5. The lease rent has already renegotiated for Waikiki Banyan and you are currently paying a higher lease rent. Lease rents will renegotiate again in less than three (3) years.
6. The leased fees may be made available for sale to 3rd party investors.
7. There can be no assurances that the Sellers will reoffer the leased fees again.
8. As discussed in the attached summary of the informational meeting, future leased fee offerings would likely be at a higher price as have been the case when comparing the price to prior offerings.
9. As discussed in the attached summary of the informational meeting, with about 17 years remaining on your lease, your apartment may be more difficult to finance, both for you to take advantage of today's low interest rates, as well as for a buyer if you choose to sell your apartment.

Even if you did not qualify for a loan to purchase the leased fee last time, you may wish to consider talking with a lender because today's low interest rates should reduce monthly payments and with more fee simple sales in your project, appraisers may have more information to value your apartment in fee simple. In addition, there may be some reduction in the principal balance of your leasehold mortgage loan. Please see Question No. 52 of the attached summary.

THE OPINIONS AND VIEWS EXPRESSED AT THE MEETING, IN THIS LETTER AND IN THE ENCLOSED QUESTIONS AND ANSWERS SUMMARY ARE THOSE OF SAVIO REALTY LTD., AND SHOULD NOT BE ATTRIBUTED TO SELLER.

If you did not attend our informational meeting or did not pick up your packet from our office, I am sending to you a packet of information that was distributed at the meeting. In the packet of information, you will find a Sales Contract that can be completed if you are interested in acquiring your Seller's leased-fee interest in your apartment. I am also including a summary of the informational meeting that was held on July 18, 2018, that announced the sale of the leased fees. The summary is in a questions and answers format. If you received your packet of information, then I am sending to you only the summary of the informational meeting.

The mailing of this letter will trigger the 90-day quiet period, as required under an amendment to the Right of First Refusal law. We cannot contact you or your agent for 90 days following the mailing of this letter unless you or your agent calls us to request information. If requested, we are more than happy to assist you and your agent in whatever way we can. We apologize in advance for any inconvenience this may cause you or your agent, but we must comply with the law.

After you review the packet of information and the summary of the informational meeting, you should consider accepting the offer contained in the enclosed Sales Contract before it is made available for purchase by 3rd party investors so that you can own the Seller's leased fee interest in your apartment. As provided in the Sales Contract, if you accept the offer and submit the completed Sales Contract, you will have the right to terminate the Sales Contract without cost for a period of 90 days after such acceptance. Refer to Section H of the Sales Contract for more information. Please note the following deadlines:

“Acceptance Deadline” is November 27, 2018: An offer that is not properly accepted on or before this date will expire. After the expiration date, the unsold leased fees will be made available for sale to 3rd party investors at the same price.

“Change Deadline” is January 11, 2019: If you accept, this is the last date to request changes to how you hold title, to add someone to title, etc.

“Closing Deadline” is February 25, 2019: If you accept, this is the date by which you must close on your purchase of the leased fee.

Please take the opportunity to review the enclosed questions and answers. A table of contents is included to assist you in seeing which questions might be of interest to you.

If you have any questions about the Sales Contract, the enclosed summary, or the conversion program, please feel free to call our sales office at (808) 955-6632 and speak with any of our sales agents. The name of the specific sales agent of Savio Realty Ltd. that has been assigned to answer questions (that you or your agent may have) appears on your mailing label.

Sincerely,

A handwritten signature in black ink that reads "Peter Savio". The signature is written in a cursive, flowing style.

Peter B. Savio (R)
President

Enclosure

WAIKIKI BANYAN

Questions and Answers

Summary of Meeting held on July 18, 2018

THE OPINIONS AND VIEWS AT THE MEETING AND IN THESE QUESTIONS AND ANSWERS ARE THOSE OF SAVIO REALTY LTD., AND SHOULD NOT BE ATTRIBUTED TO LIL'UOKALANI TRUST.

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1. **Who is Savio Realty Ltd.?**

Savio Realty Ltd. (“**SRL**”) is a Hawai‘i real estate brokerage company retained by your lessor, Lili‘uokalani Trust (“**LT**”), to assist in the sale of LT’s leased fee interest in the land and each apartment in Waikiki Banyan (referred to for convenience as the “**Leased Fee**”). SRL specializes in lease-to-fee conversions. Peter Savio, owner of SRL and a licensed broker, has assisted in converting over 26,000 apartments in over 230 buildings, more than any other broker in Hawai‘i.

2. **What is the purpose of the meeting?**

The terms and conditions of the sale of the Leased Fees are contained in the sales contract that were distributed at the meeting or mailed to lessees (“**Sales Contract**” or “**Offer**”). SRL has been asked to summarize such terms and conditions and to answer any questions concerning the Sales Contract and procedures.

In SRL’s experience, lease-to-fee conversions are often misunderstood. As such, SRL, not LT, has called the meeting to explain why SRL believes that purchasing the Leased Fee makes sense. The opinions and views at the meeting and in these Questions and Answers are those of Savio Realty Ltd., and should not be attributed to LT (Lili‘uokalani Trust).

3. **Who is offering to sell the Leased Fee? Who is the lessor?**

The Trustees of Lili‘uokalani Trust are collectively the “lessor” under the Master Lease (as described below) in Waikiki Banyan (the “**Project**”). They are offering to sell the Leased Fees.

4. **Who is the Offer being made to?**

The Offer is being made to lessees of record or to the purchaser (vendees) under a recorded agreement of sale for the purchase of a leasehold apartment in the Project, but excluding time share lessees as described below. Eligible lessees and vendees are referred to, for convenience, as “**you**” or “**Lessees**.”

A buyer of the Leased Fee cannot be a lessee under a sublease for an apartment that is subject to a time share declaration. The Offer is not made to and does not include any apartment in the Project where the lessee’s interest in the sublease has been submitted to a time share declaration. If Schedule A to the Sales Contract shows “Not Available” for any apartment in the Project, then LT is not offering to sell its Leased Fee in such apartment. LT reserves the right to withdraw its offer to sell its Leased Fee interest in an apartment if the sublease for an apartment is subject to a time share declaration, but a purchase price for the apartment is listed on Schedule A of the Sales Contract.

5. **If my apartment is subject to the time share declaration, but all or some of the lessees want to buy the Leased Fee, will we be allowed to buy the Leased Fee?**

Yes. LT has made available for sale to 3rd party investors the forty-five leased fees that are subject to time share declarations. The leased fee for such an apartment is not part of this offering but may be available for purchase by you as a 3rd party investor. If you are interested in purchasing the leased fee, please let us know as soon as possible because the sale of those leased fees are on a first-come-first-served basis, subject to a right of first refusal in favor of the Association of Apartment Owners (the “**AOAO**”) of the Project.

6. Does that include owner-occupants and investors?

Yes, Lessee may be owner-occupants or investors. This is a voluntary offering, and LT is willing to sell as long as you qualify as a “Lessee” as described above in Question No. 4 and the apartment is not subject to a time share declaration. As described in Question No. 5, sales of the leased fees for apartments subject to time share declarations are covered by the 3rd party investor sales program.

7. What is being offered?

Qualified lessees and purchasers of the leasehold apartment under a recorded agreement of sale are being offered an opportunity to purchase the Leased Fee from LT. The Leased Fee does not include the “sandwich position.”

LT is offering to sell its Leased Fee:

- (a) LT’s interest in the apartment, any limited common elements that are a part of the apartment, and the undivided percentage interest in the common elements of the Project that are a part of the apartment, including the land upon which the Project is situated (the reversionary interest is what LT receives after the Master Lease and Sublease discussed below expire or terminate), which interest of LT is subject to the Master Lease and Sublease discussed below (the “sandwich position”); and
- (b) A 1/876th interest of LT in a Master Lease between LT and Becker Properties & Leases, LLC, a Colorado limited liability company (“*Becker*”). By getting such 1/876th interest in the Master Lease, a buyer will be leasing to Becker the land portion of the apartment. That is, the buyer will own the apartment, including the land portion, in fee, subject to the Master Lease and the Sublease.

LT is the lessor (landlord) and Becker is the lessee (tenant) under a Master Lease, which Master Lease has an effective date of December 1, 1977, and an expiration date of November 30, 2035 (“*Master Lease*”). Becker has leased the land portion of the apartment to you (Lessee) under a sublease (the “*Sublease*”), and Becker is the sublessor (sub-landlord) and you (Lessee) are the sublessee (sub-tenant) under the Sublease.

8. What is the “sandwich position” and what is a “CCD”?

Sometimes Becker’s interest is referred to as a “sandwich position” because Becker’s position is “sandwiched” between the Master Lease and the Sublease. Sometimes this Sublease is referred to as a “CCD” because the instrument used for this Sublease is entitled “Condominium Conveyance Document.”

9. Will Becker sell its sandwich position?

Becker’s interest in the Master Lease and the Sublease is not a part of LT’s Offer and is not included in the purchase price. There are two things that could occur as described below. For easier reference, any buyer who actually acquires (closes on the purchase of) the Leased Fee from LT is referred to as the “*Leased Fee Apartment Owner*.”

- (a) Becker could sell its interest to the Leased Fee Apartment Owner directly. In such a case, the Leased Fee Apartment Owner will become the owner of the apartment in fee simple and will no longer pay rent under the Sublease. LT has not made any arrangements to purchase Becker’s interest nor will LT agree to allow Becker to sell its interest as part of this offering.

Previously, Becker has offered to sell its interest and has indicated an interest in reoffering it again.

- (b) If Becker does not sell its interest or the Leased Fee Apartment Owner elects not to buy Becker's interest, LT has arranged for the Leased Fee Apartment Owner to reduce its rent payments under the Sublease.

10. If I become the Leased Fee Apartment Owner and lessor for the 1/876th interest in land that is a part of my apartment, will I still need to pay lease rent to LT?

No, you will no longer be required to pay lease rent to LT because you would have purchased LT's position, but you will still need to pay rent to Becker, the owner of the sandwich position.

11. If I become the Leased Fee Apartment Owner and lessor for the 1/876th interest in the land that is a part of my apartment, will I receive rent under the Master Lease?

Because you will own only a 1/876th interest in the Master Lease, you will not receive any rent under the Master Lease that is unrelated to your 1/876th interest. As described below, LT has arranged to reduce the rent due under the Sublease by the amount by which you would have received under the Master Lease for your 1/876th interest.

12. How much rent will I need to pay Becker until December 1, 2020, the next rent renegotiation date?

As noted above, LT has arranged for the Leased Fee Apartment Owner to reduce its rent payments under the Sublease. The current yearly rent under the Sublease is \$2,016.72 (inclusive of Hawaii general excise tax reimbursement at 4.712% ("**GET**") - \$1,925.97 plus GET). Of that yearly amount, \$1,753.67 (\$1,674.76 plus GET) represents a payment towards the Master Lease and Becker retains the remaining balance of \$263.05 (\$251.21 plus GET). Immediately upon your acquisition of the Leased Fee, the yearly rent under the Sublease will be reduced to \$263.05 (\$251.21 plus GET). This \$263.05 (being the reduced yearly rent and GET) equates to \$65.76 per quarter or \$21.92 per month. This will continue until the next rent renegotiation date, which is December 1, 2020.

13. Is there another way of explaining the reduced rents that I would need to pay under the Sublease if I buy the Leased Fee?

As indicated in Question No. 12 above, your rent payments end up being apportioned between LT and Becker. That is, while you are actually making a full payment to Becker who then remits a proportionate share to LT, as the master lessor, the following example of what you need to pay before and after your purchase of the Leased Fee **presents the payments "as if" they were made to LT and Becker separately** to better highlight the before and after difference:

Before: Your \$2,016.72 payment ➤ ↗ \$1,753.67 to LT
↳ \$263.05 to Becker

After you acquire the Leased Fee, your reduced yearly rent payment under the Sublease (with GET reimbursement) is apportioned as follows:

After: Your \$263.05 payment ➤ ↗ \$---0--- to LT
↳ \$263.05 to Becker

14. Has Becker made a decision on whether to sell the sandwich position?

Previously, Becker offered to sell and sold its interest to Leased Fee Apartment Owners and has informed LT that it is interested in reoffering it again. If you have any questions, you should contact SRL at any time (even before the expiration of the quiet period). Please note that Becker's interest is a rental stream, which value decreases as the remaining term of each of the Master Lease and Sublease gets shorter. As noted above, LT does not intend to purchase Becker's interest nor will LT agree to allow Becker to sell its interest as part of this offering.

15. Who does SRL represent and how is SRL compensated?

SRL represents LT and LT will pay SRL a commission of three percent (3%) of the sales price for the sale of a Leased Fee. If there is a "Cooperating Broker" as discussed below, LT will pay SRL a commission of four percent (4%) of the sales price of the sale of a Leased Fee and SRL will keep three percent (3%) and will pay one percent (1%) to the Cooperating Broker. These payments will be made through escrow and will be due and payable only if and when the sale does close.

16. What is a Cooperating Broker?

A cooperating broker is a licensed real estate broker who represents a purchasing Lessee or whose salesperson represents a purchasing Lessee. The cooperating broker is not a "subagent" of LT and is not a "subagent" of SRL. That means that the cooperating broker does not represent LT and does not represent SRL. In order for your agent to be a "Cooperating Broker" and eligible for a commission from SRL, (a) your broker must sign a Cooperating Broker Agreement with SRL, (b) you must complete the first page of the Sales Contract (paragraph IV) by giving the name of your cooperating broker or salesperson, and (c) your broker or salesperson must attach the agreement to your Sales Contract when it is submitted to SRL. No commissions will be paid to SRL or to the Cooperating Broker if the sale of the Leased Fee does not close.

17. Should a Lessee get a Cooperating Broker?

A cooperating broker would assist you in the purchase of the Leased Fee. Whether you retain a cooperating broker, you will pay the same price for the Leased Fee. Please let SRL know in writing if you are represented by a cooperating broker because SRL will communicate with the cooperating broker and not directly with you, unless you direct us otherwise.

18. Has the Right of First Refusal been triggered?

Yes. LT sent to the president of the AOA of the Project and to Hawaiiiana Management Company, Ltd. (the management company) a copy of the Sales Contract and gave the AOA of the Project a right of first refusal to purchase the Leased Fees at the same price as listed in Schedule A of the Sales Contract. The right of first refusal statute states, in part, "Any board of directors of the AOA may fully or partially waive its right of first refusal at any time with written notice to the lessor; **provided, that it shall waive its right of first refusal with respect to the leased fee interest appurtenant to a lessee's apartment at the written request of the lessee.** The legislature hereby gives the board of directors of the AOA the authority to exercise the foregoing waiver without having to amend any bylaws, charter, or other governing documents." The highlighted

portion provides that your AOA must waive its right of first refusal if any Lessee makes such a request to the AOA. The waiver forms are available in our office upon request. In the prior offerings, your AOA responded in a timely manner in waiving its right of first refusal.

19. When do I need to accept the Offer so that I can purchase the Leased Fee? Can I accept early?

The “**Acceptance Deadline**” as described in the Sales Contract is **Tuesday, November 27, 2018**. Yes, you may accept the Offer at any time on or before the Acceptance Deadline by completing, signing, and submitting the Sales Contract to SRL. Even if you accept early, you may, but you are not required to, close early. You will have until the Closing Deadline (described below) to close.

20. What will happen if I don’t accept the offer by the Acceptance Deadline?

LT intends to make the Leased Fee available for sale to 3rd party investors if you decide not to purchase. That is, after the Acceptance Deadline, 3rd party investors will have the opportunity to purchase the Leased Fees that lessees have decided not to purchase. If a 3rd party investor submits an offer to LT to purchase a Leased Fee (which LT is willing to accept), your AOA will be given a right of first refusal to purchase such Leased Fee at the same price, however, the lessee will **not** be given a right of first refusal.

21. When do I need to close if I accept the Offer? Can I close early?

The “**Closing Deadline**” as described in the Sales Contract is **Monday, February 25, 2019**. Yes, you may close on your purchase at any time on or before the Closing Deadline. If you wish to close before November 27, 2018 (about 132 days after the offer date) and if the AOA has not waived its right of first refusal, please work with escrow to obtain such a waiver from the AOA. As described in Question No. 18 above, the AOA is required to waive its right of first refusal if you make a written request.

22. If I accept the Offer but change my mind, may I cancel the Sales Contract?

You may cancel the Sales Contract at any time during the first 90 days after you contracted. After that, but before the Closing Deadline, you may cancel the Sales Contract but the \$1,000 deposit will be used for fees and costs incurred by escrow and the balance, if any, will be paid to you. After the Closing Deadline, you or LT may cancel the Sales Contract, the \$1,000 deposit will be used for fees and costs incurred by escrow and the balance, if any, will be paid to LT. In either case, if escrow incurred more than \$1,000 in fees and costs, you will need to pay the balance. Please refer to the Sales Contract for more details. Note that if you cancel, LT intends to make the Leased Fee available for purchase by 3rd party investors as described in Question No. 20.

23. If I have questions, whom should I call?

If you have any questions regarding contracting, financing, closing, etc. or have any problems or concerns, please call and ask your broker or salesperson or if you have not retained an agent, you may call our office and ask to speak to a salesperson of SRL assigned to assist you. The name of such SRL sales agent appears on the mailing label of this letter. Under an amendment to the Right of First Refusal law, we cannot contact you or your agent for 90 days following the mailing of this Questions and Answers summary of the informational meeting unless you or your agent calls us to request information. This 90-day period is sometimes referred to as the “*quiet period*” and it ends on November 6, 2018. We are more than happy to assist you and your agent in whatever way we

can, but you or your agent will need to contact us during this quiet period. We apologize in advance for any inconvenience this may cause you or your agent, but we must comply with the law.

24. Does the Board of Directors of the AOA for the Project support the fee conversion?

The Board of Directors was informed of the conversion the same way you all were. It is SRL's opinion that an officer on the Board of Directors should never support or oppose a lease-to-fee conversion. The Board of Directors should only see that information is provided so Lessees can make their own decision whether or not to purchase the Leased Fee.

25. What information do you have about the Project (Waikiki Banyan)?

SRL has come up with the following information on the Project:

Number of units: 876 residential apartments (leased fee of 831 residential units offered for sale)

Converted to Fee: 766 residential apartments excluding 45 timeshare units (92%) are now in fee after former Lessees purchased the leased fees when previously offered, but many are still subject to Becker's interest (as described above).

Leased Fees Offering: 65 Leased Fees for non-timeshared residential apartments. (LT's leased fee interest in any apartment that is subject to a time share declaration is part of a 3rd party investor sales program.)

Improvements: Two buildings – Makai Tower being a 36-story building and related improvements and Mauka Tower being a 37-story building and related improvements.

Land Area: About 99,802 square feet

Renegotiation Date

For Rent: December 1, 2020 (Rent is to be set for the remaining term of fifteen years.)

Expiration Date: November 29, 2035 - expiration date of each Sublease and November 30, 2035 – expiration date of the Master Lease.

Lease Rent: The current yearly rent under the Sublease is \$2,016.72 (inclusive of Hawaii general excise tax reimbursement at 4.712% (“GET”). Of that yearly amount, \$1,753.67 (inclusive of GET) represents a payment towards the Master Lease and the sandwich owner (Sublessor) retains the remaining balance of \$263.05 (inclusive of GET).

Please see Question Nos. 12 through 13 on the reduced rent that you will still need to pay even if you purchase the Leased Fee.

26. What is the Leased Fee?

Surprisingly, there is considerable misunderstanding of what is the Leased Fee. To start from the beginning, the following is an explanation of how the Project was created.

LT, Kawaihāo Church, and the developer recorded a declaration of condominium property regime against their interests and created 876 fee simple condominium apartments. Each condominium apartment can be described as having three components: (1) the apartment itself which is for the exclusive use by the owner or lessee of the apartment, (2) limited common elements which are for the exclusive use of only certain owners or lessees, and (3) common elements which are for the common use of all owners or lessees of the Project. The apartments in the Project do not have any

limited common elements. This is one way to view an apartment, showing just a few of the components of the common elements:

Apartment	Apartment 1 Bedroom, 1 Bath
1/876 th undivided interest in the Common Elements of the Project, as tenants in common with other owners and lessees.	Walkways, Outdoor Structures
	Landscaping
	Roofs, Load Bearing Walls, Columns
	Electrical, Water, Sewer, and Other Systems
(Leased)	Land

The apartment has a 1/876th interest in the common elements of the Project, including the land, as tenants in common with other owners and lessees. A common misconception is that the AOA owns the common elements. The AOA does not own the common elements, but only manages the common elements for the benefit of all owners and lessees.

After the condominium apartment was created, the developer (now Becker) leased the land component of each apartment under a “Waikiki Banyan Condominium Conveyance Document” (the “*Sublease*”) and the developer deeded the improvements to the lessee. As discussed above, Becker still maintains this sandwich position. This arrangement is similar to a regular rental agreement for an apartment but is different in three significant ways: the land is leased, the term is set for about 55 years, and rent is based on the land value of the Project. At the expiration of the Sublease, all of the lessees must agree to demolish and remove the building at their cost and if they all do not agree, the lessor must buy the building for \$50,000. Each lessee will share the \$50,000 equally – only \$57.08 for each apartment (\$50,000 divided by 876 = \$57.08). The likelihood of all of the then lessees agreeing to pay for the demolition of the building is very remote. Thus, for purposes of this discussion and if no apartment is converted to fee, the then lessor would get the apartments (land and improvements) at reversion upon the payment of \$50,000 to the AOA.

If you rent your apartment, you will receive rent from your tenant (**income**), the tenant will use the apartment, and you will get back the use of the apartment when the rental ends (or if the tenant defaults) and when the tenant leaves (**reversion**).

Similarly, LT has rented the Project land to Becker and Becker has rented an undivided 1/876th interest in the Project land to you. LT will receive rent from Becker and Becker will receive rent from you (**income**), and LT will get back the apartment (not only the land) when the Master Lease and the Sublease expire (**reversion**). If you default, Becker will get the apartment for the term of the Master Lease and when the Master Lease expires, LT will get the apartment. The Master Lease and the Subleases all expire about the same time.

- Each Leased Fee is (a) a 1/876th interest in the fee simple land that is subject to the Master Lease and the respective Sublease and (b) the lessor’s 1/876th interest in the Master Lease.
- If you purchase the Leased Fee, you will pay the reduced rent (or not have to pay yourself rent under the Master Lease) and receive the **reversion** when the Master Lease and the Sublease expire (you will not have to return the apartment to LT).
- As discussed above, Becker’s position is only a rental stream with no reversion. If you purchase the Leased Fee, you will receive the reversion in the apartment after the Master Lease and the Sublease expire and Becker will **not** receive any reversion in the apartment.

27. **What happens when the Master Lease and the Subleases expire and some Lessees in the Project have not converted to fee ownership?**

Each Lessee who purchased the Leased Fee will own its apartment in fee simple and the lessor (LT or 3rd party investor) will own the other apartments in fee simple, although the lessor (LT or 3rd party investor) must pay to the AOA a proportionate share of the \$50,000 based on the total percent common interests for such unconverted apartments.

What happens to the land? This is a common question. As you can see, this question comes from a misunderstanding that LT only owns the land at reversion. As in the illustration above, each condominium apartment owner has an undivided interest in the land and the land is a part of the common elements of the apartment. The reversion is the apartment, which includes the land.

Why do appraisers, attorneys, brokers and others talk about buying the land on a conversion? Some of it comes from not really understanding condominium properties. Condominiums are created by statute and apartments are created as separate real properties that can be conveyed. An individual dwelling unit in an apartment building that is not a condominium apartment cannot be sold – the entire apartment building needs to be sold. Some of it comes from the lease-to-fee conversion of single-family lots, where just the lot was leased and the improvements may be removed prior to reversion. Some of it comes from confusion on rent being set on land value but the reversion being the entire apartment. Some of it comes from confusion on how a Master Lease and Sublease work. Some of it comes from using land as a short-cut reference. Once these references to land are set, it is easy to get confused.

28. **What am I paying for when I purchase the Leased Fee?**

One way to answer this question is to understand what LT would get if it did not sell the Leased Fee.

Income: As to your apartment, LT would receive 1/876th of the entire rent under the Master Lease from July 18, 2018 to November 30, 2020 (about 2 $\frac{1}{3}$ years). Then for the next fifteen years it would receive 1/876th of the entire rent based on 7% times the land value for the Project as of December 1, 2020. (1/876th is the common interest allocated to your apartment).

Reversion: On November 30, 2035, the Master Lease and the Sublease will expire and LT will own the apartment in fee simple.

Income: Except for the current rent, the rest of the rent amount that LT will receive from December 1, 2020 is an estimate. To estimate this amount, different appraisers use different assumptions. A common assumption among Hawai'i appraisers is to use a 3% appreciation rate. That means they take the current estimated value of the project land and assume that it appreciates at 3% per year, compounded, until 2020 and will use that to estimate the future rent. Other appraisers may not agree with this 3% per year appreciation rate.

Reversion: Although LT will receive the apartment on reversion, because it will not occur for nearly 17 $\frac{1}{3}$ years, most Hawai'i appraisers will use the land value only and not the apartment value to determine the value of the reversion. Other appraisers use the estimated value of the fee simple apartment at reversion. You could estimate the current value of your apartment in fee simple and make your own assumption on what it will be worth in 17 $\frac{1}{3}$ years. As discussed above, the apartment includes the improvements and an undivided interest in the land. When apartments are bought and sold, the improvement value and the land value are not considered separately. Thus, the apartment value referred to above includes both the value of the improvements and the land.

Discount: Obviously, we cannot end here because LT will not receive today the entire amount or value of the rent and reversion. So appraisers will apply a discount on the idea that \$1 today will be worth less in 2½ and 17½ years, when the rent re-opener and reversion take place. How much is an appropriate discount to apply is an issue with different appraisers. You could make your own assumption on the discount rate.

29. How many units have converted voluntarily?

Today I would estimate statewide that 80,000 to 100,000 condominium and cooperative apartments have converted from leasehold to fee simple voluntarily with the majority within the last 20 years. It is interesting to note that from 1960 to 1980 when the old appraisal methods were used, almost no one converted. The low lease rent and lease being years from renegotiation and surrender resulted in lessees having no incentive to buy unless at a low price. Under the new valuation methods since 1980, voluntary conversions have become the dominant force in the marketplace. The conversion also became more important as leases got shorter and closer to renegotiation. Because the term of your Sublease has now dropped below 18 years, I understand that the IRS will no longer consider the entire apartment as real estate and if so, you cannot do a 1031 exchange with your leasehold apartment.

30. How many units have converted at the Project (Waikiki Banyan)?

LT's lease-to-fee conversion program is a success and the former lessees of 766 apartments (92% of those Leased Fees offered excluding 45 timeshare units) have closed escrow and now own the fee interest in their apartments, although many are still subject to Becker's position as described above. LT is also re-offering to sell its non-timeshare leased fees at Waikiki Banyan to all lessees thereof, and, after the Acceptance Deadline, LT intends to make the leased fees available for purchase by 3rd party investors. As discussed above, the leased fees for apartment subject to time share declaration are part of a 3rd party investor sales program.

31. How many units have converted at Liliuokalani Gardens at Waikiki?

LT's lease-to-fee conversion program is a success and the former lessees of 367 apartments (95%) have closed escrow and now have fee simple ownership of their apartments. LT is also re-offering to sell its leased fees at Liliuokalani Gardens at Waikiki.

32. How many units have converted at Waikiki Sunset?

The lease-to-fee conversion program is a success and the former lessees of 415 apartments (95%) have closed escrow and now have fee simple ownership of their apartments. LT and St. Francis Medical Center are also re-offering to sell their respective leased fees at Waikiki Sunset.

33. How many units have converted at Foster Tower?

LT's initial lease-to-fee conversion program is a success and the former lessees of 97 apartments (73%) have closed escrow and now have fee simple ownership of their apartments. LT is also re-offering to sell its leased fees at Foster Tower.

34. Can we remain leasehold?

Yes, you can. Your Sublease will remain as it is. You will continue to pay lease rent. You will renegotiate the rent on December 1, 2020, and Hawai'i law currently provides that the AOA will represent you in the setting of the rent. Your Sublease will expire on November 29, 2035.

If you decide to buy the Leased Fee at some future date, there is no assurance as to if and/or when LT or 3rd party investor will be interested in selling or whether either of them will be willing to take a discount off of what it estimates it will receive under the Master Lease. I believe remaining leasehold is not a good option.

35. How have the newer valuation methods affected voluntary conversions?

From 1960 to 1980, there were very few voluntary conversions. Most leased fees, when sold, were sold to institutional investors such as insurance companies and trust companies. Investors sometimes purchased the leased fee from the lessors and resold at higher prices to the lessees. Based on the example above, such investors (a) used low estimates of what the lessor would get in lease rent, (b) gave almost no credit for the reversion, and (c) discounted what the lessor would receive to arrive at a low leased fee price. Few lessors wanted to sell at those low prices.

In 1980, lessees realized that they should be willing to pay more than the investors because if the lessee purchased the leased fee, the lessee would own the apartment in fee simple (leasehold plus leased fee = fee simple). The competition between investors and lessees caused prices to increase. Lessees started buying through the AOA with apartments in about 15 buildings being converted from 1980 to 1985.

In 1985, a more flexible conversion program was developed and lessees under the newest method could buy directly from lessors. Lessors saw they were now getting prices in line with the market. Selling their leased fees now made sense. From 1985 to date, apartments in hundreds of buildings have converted with the majority using this new method. The new method is called the Individual Sales Method and is the method being used in your Project.

36. What are the three ways leased fees have been sold?

The three methods are as follows:

The Historic Method: This is the original method used primarily from 1960 to 1980. The pricing was based on what an investor was willing to pay to buy a stream of income. Because the remaining lease terms were so long, little or no credit was given for the reversion – what the lessor would get at the end of the lease. This method was basically eliminated from the conversion market by the State passing the Right of First Refusal law. Even if a lessor is willing to sell at a price using this method, investors are not willing to negotiate and spend the time and effort to contract to purchase at this low price because the AOA will exercise its Right of First Refusal and purchase the leased fees. That is, when there is a contract for the sale of the leased fees to the investor, the lessor is required to give the AOA a Right of First Refusal to purchase at the price stated in the Sales Contract. If the price is low, the AOA will exercise its Right of First Refusal and will buy at the low price. The investor's ability to buy a stream of income at a low price to resell to lessees is no longer possible because the Right of First Refusal gives the AOA the right to buy at that price. This historic method is seldom, if ever, used today. It should be noted, however, that as lease terms become shorter, investors might be willing to pay more than the value of the stream of income. Accordingly, as investors are willing to pay more for the leased fees, the AOA may not be able to match the investor's price.

The 100% Purchase Method: This was the primary method used from 1980 to 1985. Lessors recognized that lessees should be willing to pay more than an investor because upon conversion, the lessee would own the apartment in fee simple. As lessees were willing to pay more than investors, lessors were encouraged to sell their leased fees. Under this method, the leased fees in 100% of the apartments were sold to the AOA, even if lessees of less than 100% of the apartments wished to buy. The AOA became the lessor of the apartments for the lessees who did not buy the leased fees. Under the previous law, lessees who bought their leased fees also paid the cost of those who remained leasehold. The AOA, as lessor, became responsible for the cost of collecting and administering the unsold leased fees. From 1980 to 1985, apartments in about 15 projects converted under this method.

The Individual Sales Method: This is the current and most popular method. Each lessee is offered the leased fee directly and is free to convert to fee simple or remain leasehold. This avoids the problem and cost of administering the unsold leased fees by the AOA because the lessor is still the owner and responsible for the unsold leased fees. From 1985 to date, apartments in over 300 projects have converted to fee, with the majority using the Individual Sales Method.

LT is offering the Leased Fees to Lessees under the Individual Sales Method.

37. How do appraisers value leased fees and why are there so many differences on opinions of value?

As discussed above, there are assumptions that need to be made on:

- (a) What will the lessor receive during the balance of the lease term (rental income and value of the reversion)?
- (b) What is a fair discounting of what lessor will receive during the balance of the lease term?

The lower the estimates for (a) and the higher the discount for (b) would lead to a lower leased fee value.

The higher the estimates for (a) and the lower the discount for (b) would lead to a higher leased fee value.

Appraisers will evaluate what is going on in the marketplace on land values to estimate future rents, what leased fees are selling for to see what is a fair discount rate, how residential real estate has increased in value to estimate the appreciation rate, etc. Appraisers also look at leased fee sales prices to determine the leased fee value. Looking at only the income that the lessor will receive to value the leased fee is incomplete. After all, that is not how leasehold and fee simple residential properties are typically valued.

38. What are the correct assumptions on the future value of the land and the future value of the reversion and the correct discount of those amounts?

Those are all matters that have no one “correct” answer, but I believe that if you look at what LT would probably receive in the future and you look at what LT is willing to sell at now, I think the prices for the Leased Fees are fair.

39. How are leasehold apartments valued?

Residential leasehold apartments could be valued using two methods.

- A. Market Method:** Compare what other similar leasehold apartments are being sold for.

B. Income Method: Determine the net rental stream until the apartment lease or sublease expires and discounting it.

The market method is the approach most lessees want to use to sell their leasehold apartments. It usually gives the lessee the highest value. Typically, that is why lessors did not sell under the old appraisal methods, which was based primarily on the estimated rental income.

40. I thought I own the improvements and on condemnation, I get the value of the improvements. Does the price for the Leased Fee include the value of the improvements?

Your Sublease provides that if there is a condemnation (eminent domain taking) of the Project (which is very different from a condemnation of the Leased Fee), your Sublease will terminate. That is, you will no longer have a leasehold interest in the land. When the condemnation proceeds from the taking are paid, you will get the value attributed to the improvements and LT will get the value attributed to the land. In that case, LT will get the reversionary value of the land earlier and not later. If there is no condemnation, then LT will get the reversionary value in the apartment at the expiration of the Sublease. In either case, by purchasing the Leased Fee, you are not paying for the current value of the improvements. You are paying for the reversionary value of the apartment so that it will not revert to LT or the then lessors when the Master Lease and Sublease expire.

41. Does the price for the Leased Fee take into account the number of parking stalls (if any) that an apartment has?

No, it does not. The price for the Leased Fee also does not take into account other items such as the current value of any improvements made to your apartment.

42. Are the prices for the Leased Fees fair?

Each lessee must make his/her own decision. It appears to me that the prices are in the proper range of what the Leased Fees are worth but I am not an appraiser.

43. Will LT accept a lower offer on price?

These are the prices LT will accept. LT does not intend to make the Leased Fee available to 3rd party investors at a price lower than the price being offered to you. To remain leasehold in the present situation may not be a good choice because time favors the lessor and land and real estate values have historically risen in Hawai'i.

44. Why do some lessors use the 100% Method if the price they receive is lower?

They may have received legal, tax or accounting advice to do so. Usually, the lessor does not want the expense or hassle of handling the unsold leased fees and will take a discount to avoid the expense and liability.

45. Do Boards of AOAOs ever use the Individual Sales Method?

Yes. Not all Boards agree with those who feel the 100% Method is the best method. We have and are presently in the process of converting apartments in several buildings to fee simple ownership representing either the lessees or the AOAO. In projects where we are or were representing lessees, the leased fees were originally offered by the lessor to lessees using the 100% Method. The lessees did not want to buy under the 100% Method so they asked us to assist them in converting the lessor's program using the 100% Method to the more popular Individual Sales Method.

46. Is the 100% Method preferred by lessees or lessors?

The 100% Method is only one of two methods to do a lease-to-fee conversion. Some lessees and lessors prefer it while others do not. I personally believe the Individual Sales Method is superior. Both methods are valid.

47. What is the test to make sure the Leased Fee price is fair?

In a conversion of a leasehold apartment to a fee simple apartment, there are three values. The values are the Leasehold Apartment Value, the Leased Fee Value (lessor's interest) and the Fee Simple Apartment Value.

$$\frac{\text{Leasehold Apt. Value}}{A} + \frac{\text{Leased Fee Value}}{B} = \frac{\text{Fee Simple Apt. Value}}{C}$$

- A. **Leasehold Apartment Value:** Determined by the market. Hundreds of brokers and clients buying and selling leasehold apartments.
- B. **Leased Fee Value:** Lessors' interest traditionally determined by appraisal using a mathematical formula and available market data.
- C. **Fee Simple Apartment Value:** Determined by the market. Hundreds of brokers and clients buying and selling fee simple apartments.

48. Will the value of my apartment increase by the price of the Leased Fee?

You should not buy the Leased Fee hoping your apartment value will increase by more than the Leased Fee purchase price. You should purchase the Leased Fee to preserve your apartment's value and remove uncertainties related to the ownership of a leasehold apartment. Purchasing the Leased Fee should not be to speculate on resale values as much as it should be to preserve your apartment's value.

If the leasehold value is a correct market value and you add the price of the Leased Fee, the new fee simple apartment should be worth that or more but let me give you an example.

In one building I did, an owner said his leasehold apartment was worth \$600,000 and the leased fee cost \$80,000. He said he could not sell his fee simple apartment for \$680,000. One year later, he could only get \$500,000 for the fee simple apartment. He felt he had lost money by buying the leased fee. When we did comparables for the project, we found that leasehold apartments were selling for \$400,000 and not \$600,000 and fee simple apartments were selling for \$500,000. He had basically overvalued his leasehold apartment. You should not buy the Leased Fee to make a profit. There is no guarantee or assurance. You should buy to protect your leasehold apartment. You buy the Leased Fee because it makes sense if you plan to sell or refinance your apartment. You buy because you won't have to deal with lease rent renegotiation, reversion, etc.

49. If real estate prices go down, will I be able to purchase the Leased Fee at a lower price?

As described in the answers to Question Nos. 28 and 37, because the price of the Leased Fee takes into account the value of LT's rights under the Master Lease, particularly the lease rents to be received during the remaining term and the value of the reversionary interest in the Apartment at expiration of the Master Lease and the Sublease, the Leased Fee should gain value as the number of years to the next rent negotiation and to Master Lease and Sublease expirations decreases – that is, 2½ years from now, there will be another rent renegotiation and only another 17⅓ years to Master

Lease and Sublease expirations. Accordingly, the price of the Leased Fee is less affected by general real estate prices as compared to predictions and estimates on what future land values might be at the time of rent renegotiation and what the future reversionary value of the Apartment might be at the expiration of the Master Lease and the Sublease. It is a long-term prospect.

50. What will the lease rent be in 2020?

No one knows what the lease rent will be at renegotiation in 2020, but it will be based on 7% times the land value for the Project as of December 1, 2020, times the percent common interest allocated to your apartment (1/876th), plus the amount payable to Becker.

51. Is it cheaper to rent or buy?

In the long run, I believe that it is cheaper to buy, but that is a determination that you need to make after considering your financial situation. I understand that interest rates on a mortgage are in the range of 4¼% to 4½%; however, even if you purchase LT’s Leased Fee, you will still need to pay rent at a reduced rate with GET. Based on the current purchase prices for some of the more typical units, interest only monthly payments (rounded) would be as follows:

<u>Interest Only</u>	<u>4¼% Interest Rate</u>	<u>4½% Interest Rate</u>
One-Bedroom at \$191,500	\$678.23	\$718.13
Reduced Sublease payments.	\$21.92	\$21.92
Total amount	\$656.31	\$696.21
<u>Monthly Rent (Including GET)</u>	<u>Current</u>	<u>December 1, 2020</u>
Each leasehold apartment	\$168.06	Your Estimate

Although the lease rent you need to pay is currently much less than interest on a loan, it is not known what the rents will be for the last 15 years of the Sublease from December 1, 2020 to November 29, 2035. I am not going to give tax advice, but as a general rule lease rent is not tax deductible for owner-occupants. Interest on a loan to purchase the leased fee is generally tax deductible to owner-occupants (subject to recent changes to the tax code).

If you remain leasehold and pay the lease rents (currently \$2,016.72 per year inclusive of GET), at the expiration of your Sublease, your leasehold ends and the apartment reverts (goes back) to the lessor. If you purchase the Leased Fee, you remove the uncertainty related to the future lease rent renegotiation and in 17½ years you (or the then owner) will continue to own the apartment in fee simple.

The bottom line is that due to the unique factors facing Waikiki Banyan, the cost to remain leasehold may be more expensive than you think. Conversely, the cost to become fee simple may be less expensive than you think.

52. Why did you use a loan with interest only because I may be getting a 30-year mortgage loan?

In Question No. 51, I used interest only because I wanted to compare the cost to purchase the Leased Fee to the cost to remain in leasehold. The following example is the estimated monthly payments (rounded) if you got a thirty-year loan for the entire amount of a purchase price at \$191,500. If you obtained a loan to refinance the amount of your current loan and pay for the Leased Fee, your new monthly loan and reduced rent payments may be higher **or lower** than your current loan and lease rent payments. You should check with your lender:

<u>30-Year Amortized Loan:</u>	<u>4¼% Interest Rate</u>	<u>4½% Interest Rate</u>
One-Bedroom at \$191,500	\$942.06	\$970.30
Reduced Sublease payments	\$21.92	\$21.92
Total amount	\$920.14	\$948.38
In 30 years (2048):	Fee simple apartment and loan repaid:	

<u>Monthly Rent (Including GET):</u>	<u>Current</u>	<u>December 1, 2020</u>
Each leasehold apartment	\$168.06	Your Estimate
On November 29, 2035:	Lease terminates and apartment surrendered.	

53. Why should I buy the Leased Fee when renting is less costly for now?

That is perhaps the most asked question SRL receives when presenting lessees with the opportunity to purchase the Leased Fee (Seller's interest) and convert your apartment to fee-simple ownership.

Unfortunately, there is no simple answer to this question.

In some cases, monthly lease rent may be less than monthly mortgage payments if you acquire the Leased Fee (Seller's interest). You should, however, purchase the Leased Fee (Seller's interest) because of the advantages of being fee simple. For example, because about 17 years remain under your Sublease, if you remain in leasehold, you cannot get a new 30-year mortgage loan and you probably cannot use your leasehold apartment for a 1031 exchange.

Some of the other advantages of owning the fee simple interest in your apartment are as follows:

- A. Preserves your apartment's value as the lease term gets shorter.
- B. Fee simple apartments may appreciate by an amount greater than the cost of the Leased Fee (Seller's interest) especially compared to leasehold apartments with about 17 years remaining under the Sublease.
- C. Generally, there is a greater demand for fee simple apartments as opposed to leasehold apartments, especially compared to leasehold apartments with about 17 years remaining under the Sublease.
- D. Being fee simple may make your apartment easier to sell.
- E. Being fee simple may make your apartment easier to finance.
- F. Being fee simple may attract more owner-occupant buyers.
- G. It is doubtful you will ever be able to buy the Leased Fee at a lower price.
- H. If you do not buy the Leased Fee, a 3rd party investor may purchase it.

Furthermore, in determining whether to buy the Leased Fee (Seller's Interest), you should also compare more than just the amount of current monthly rent payments and potential monthly mortgage payments. There are a number of hidden costs that can weigh against remaining leasehold. These hidden costs are discussed more fully in Question No. 54 below.

54. What are the hidden costs to remaining leasehold and how do they affect me?

These are some of the hidden costs that affect you and your leasehold apartment:

Depreciation Due to Surrender of Apartment Upon Expiration of Lease

One hidden cost arises from the surrender clause in the Sublease. The surrender clause requires you to return your leasehold apartment to LT to a 3rd party investor when the Sublease expires on November 29, 2035. Because you have to surrender your apartment at the end of the Sublease gets closer.

As an example, let's assume that your leasehold apartment is worth \$290,000 in today's market. This is the average value of the last two one-bedroom leasehold apartment in the Project that sold in 2018. Although that apartment may be worth \$290,000 today, at the end of the lease in 17 years, the leasehold owner will need to surrender or give back the leasehold apartment to LT or a 3rd party investor. At that point, the Lessee's value in the leasehold apartment will be \$0. What this means is that as the end of the Sublease approaches, Lessees may begin to lose value in their leasehold apartments.

Assuming that your leasehold apartment is currently worth \$290,000 and that the value depreciates equally each year over the next 17 years until it reaches \$0 at the end of the term of the Sublease, you will be losing approximately \$17,059 each year or \$1,422 each month. Although no one can predict the exact value of a leasehold apartment at any given point in time, the foregoing is provide as an example only for purposes of analyzing potential hidden costs and assumes that the value of the leasehold apartment will depreciate evenly over the next 17 years.

Opportunity Cost

Fee simple apartments will generally appreciate over time, and therefore, there is an opportunity cost to remaining leasehold. This opportunity cost is the appreciation or increase in value that your apartment would benefit from over time if you owned the apartment in fee simple rather than only a leasehold interest. This opportunity cost is in addition to the possible depreciation in value that will affect the leasehold apartment as the end of the Sublease gets closer.

No one can predict how much real estate values will increase in the future, but appraisers generally use an appreciation rate of approximately 3% per year when approximating the future value of real property. SRL believes this is a very conservative appreciation rate because the appreciation rate for Hawaii real estate over an extended period of time has generally been much higher. While the rate of appreciation will vary over time and based on numerous market variables that cannot be predicted, SRL believes that a 3% rate of appreciation can be used as a reasonable guide in making a decision with respect to the true cost of remaining leasehold.

As an example, let's assume that the fee simple apartment is worth \$565,000 in today's market. This was the average purchase price of the 12 one-bedroom fee simple apartments in the Project that sold earlier this year. If you just an appreciation rate of 3% per year, the value of the fee simple apartment would appreciate by approximately \$16,950 in the first year or \$1,412 per month. Each year, you could multiply the estimated 3% appreciation rate by the value of a fee simple apartment to estimate the opportunity cost incurred by not converting to fee-simple ownership.

Interest Rates

We have all benefitted greatly by the low interest rate environment that has been with us for many years. However, these low interest rates are slowly being increased. Yes interest rates are still lower than they were in its peak many years ago, but the federal government has made it clear that it intends to raise and continue to raise interest. We have seen this happening in the past year and expect that this will continue for at least the rest of the year.

No one knows how high the federal government intends to raise interest rates, but a lender recently advised me that they expect interest rates to hit 5.5% in early fall and 6% by the end of the year.

Because mortgage loans are typically for a period of up to 30 years, a small increase in interest rates can have a big impact on the total amount you pay to the lender. As an example, if you borrow \$100,000 at an annual rate of 5.5% interest, you will pay the lender approximately \$205,000 over the life of the loan – that’s over \$100,000 in interest!

In addition, if you delay your decision to finance a purchase and interest rates increase, the amount that you pay over the 30 years for your mortgage can increase by tens of thousands of dollars even if interest rates only go up ¼%. If interest rates go up more than ¼%, the amount you will pay over the life of the loan will increase even more.

Summary of Direct and Hidden Costs

The direct cost to convert to fee-simple ownership can be measured as the monthly mortgage payment (principle and interest) you pay to your lender (Refer to Chart in Question 52).

Cost to purchase the leased fee	\$942.06 to \$970.30 per month depending on the interest rate used
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The direct cost of remaining leasehold can be measured as the leased rent that you will pay to Becker under the Sublease, including any increase in the rent upon renegotiation in December 1, 2010 (Refer to Chart in Question 52).

Current Lease Rent	\$168.06
Lease Rent in 2020 After Renegotiation	??????

Additionally, in the example used in this Question No. 54, the hidden costs for remaining leasehold can be estimated as follows:

Monthly Depreciation Due to Surrender of Apartment Upon Expiration of Lease	\$1,422
Monthly Opportunity Cost (Assuming 3% Appreciation)	\$1,412

55. What would be the monthly payments if I refinanced?

You may feel that you cannot afford to make the new mortgage payments on top of your existing mortgage payments. I believe you should talk to your lender to understand what your monthly payments will be and talk to your family members to see if they would like to participate. Please refer to the charts in Question Nos. 51 and 52. As a general proposition:

- Interest rates on a loan secured by a leasehold residential apartment could be higher than a loan secured by a fee simple residential apartment.
- If you have paid down your loan, then the monthly payments on the amount of the Leased Fee purchase price and the remaining balance of your loan could be close to your current monthly payments.
- I am not going to give tax advice, but as a general rule lease rent is not tax deductible for owner-occupants. Interest on a loan to purchase the leased fee is generally tax deductible to owner-occupants.

- Family members may be willing to help their parents or grandparents purchase the leased fee because the family members could inherit a fee simple apartment but may not want to inherit a leasehold apartment with a short remaining lease term.

56. Will the Leased Fee be offered in the future and if so, at what price?

First, the Sale Contract provides as follows:

The “*Acceptance Deadline*” is **Tuesday, November 27, 2018**, about 132 days after the Offer Date. If Buyer wishes to buy the Property on the terms and conditions of this Offer, then Buyer should accept this Offer as provided in Section C (“*Acceptance of this Offer*”) at any time before the Acceptance Deadline. If Buyer accepts this Offer, Buyer will have the right to terminate this Contract to purchase without penalty for a period of 90 days after such acceptance. Refer to Section H below for more information. **If this Offer is not accepted in accordance with the terms and conditions contained in this Offer on or before the Acceptance Deadline, then this Offer will automatically expire.**

Accordingly, the Offer (including the Purchase Price offered) expires on November 27, 2018, if not accepted on or before November 27, 2018. Please refer to the Sales Contract on how to accept the Offer. If you accept the Offer, but do not close before the Closing Deadline of Monday, February 25, 2019, then your Sales Contract will be cancelled. (You may accept and close early. See Question Nos. 19 and 21)

Second, I cannot say for sure what LT will do after February 25, 2019. I can let you know what other lessors have done once they have started to offer their leased fees for sale. These other lessors have either continually offered the leased fees for sale or taken them off the market and offered them again at periodic times in the future. Whether the leased fees were continually or periodically offered for sale, the prices seem to always increase over time. Here, LT’s last reoffer of the Leased Fees was in January 2017.

Again, I cannot tell you what LT will do because I do not know for sure. My guess, however, is that the Leased Fees may be offered for sale again. I do not know whether it might be soon or months or years in the future, but my guess is that if offered for sale again, it would be in three to five years. I also guess that the price will be increased significantly. Such increase might not be related only to changes in market conditions and the shorter term of the Sublease, but might also be related to a change in the valuation method used to establish the prices.

Lastly, after the end of the Acceptance Deadline on November 27, 2018, LT intends to make the unsold (uncontracted for) Leased Fees available for sale to 3rd party investors. If a Leased Fee is sold to a 3rd party investor, the buyer, not LT, will determine whether to sell the Leased Fee to the lessee. As described in Questions No. 20, if a 3rd party investor submits an offer to LT to purchase a Leased Fee (which LT is willing to accept), your AOA will be given a right of first refusal to purchase such Leased Fee at the same price, however, the lessee will **not** be given a right of first refusal.

57. Where can we go for financing, to get a loan?

You can go to any lender you want. SRL (not LT) is providing a list of lenders that SRL’s agents have worked with and are familiar with lease-to-fee conversions. The list is at the end of this Questions and Answers summary of the informational meeting. This is not a recommendation list and is not a complete list of all lenders, and you should check with whichever lender you want. You should start checking immediately since interest rates are currently so favorable.

Each lessee must decide when to apply for financing. You should find the lender you wish to use and take your lender's suggestion on when to apply.

If you apply now, you should make sure your lender is giving you a long term commitment that will not be subject to monthly extension fees should there be a delay.

58. Last time, I did not qualify for a loan to purchase the Leased Fee, why would it be different this time?

It depends on why you did not qualify for a loan last time. If you did not qualify because the monthly payments were too high compared to your income, then, as shown in the examples in Question Nos. 51 and 52, above, the monthly payments should be lower at today's lower interest rates. If you did not qualify because the principal balance of your leasehold mortgage loan and the price of the Leased Fee exceeded the fee simple value of the Apartment, then you should consider that there have now been a significant number of fee simple sales in the Project and appraisers can use those sales in valuing your Apartment in fee simple. In addition, depending on when you got your leasehold mortgage loan, the principal balance on your loan should have decreased somewhat. A look at the multiple listing service shows that there were 17 fee simple sales over the past six months, with a median sales price of \$565,000. By comparison, there was just 1 leasehold sale over the past 6 months for \$290,000. The 17 fee simple sales are as follows:

Apartment No.	Date of Sale	Sales Price
803-I	02/23/18	\$450,000
809-I	03/20/18	\$505,000
603-II	03/19/18	\$529,000
1611-II	04/16/18	\$535,000
1104-II	04/16/18	\$536,000
1810-II	04/05/18	\$538,000
1504-I	02/20/18	\$548,000
1704-I	02/14/18	\$565,000
2509-II	02/27/18	\$565,000
2604-II	05/31/18	\$580,000
2114-I	05/31/18	\$585,000
1714-II	05/21/18	\$590,000
2908-II	01/19/18	\$590,000
3513-II	02/05/18	\$595,000
3507-II	04/27/18	\$599,000
3608-I	03/14/18	\$608,000
3808-II	04/18/18	\$660,000

The one leasehold sale is as follows:

Apartment No.	Date of Sale	Sales Price
1108-II	04/30/18	\$290,000

59. How large of a deposit is required with the Sales Contract?

A \$1,000 deposit is required, which is refundable except as provided in the Sales Contract.

60. Who should the deposit check be made payable to?

The check for \$1,000 should be made payable to Title Guaranty Escrow Services, Inc.

61. How can I pay for the Leased Fee purchase price?

There are a number of methods that can be used, including:

- A. Pay cash.
- B. Obtain a new first mortgage on your soon to be fee simple apartment.
- C. Obtain a loan by mortgaging other property.
- D. Draw on or put in place a line of credit loan.

62. The Sales Contract has space for two Lessees and our apartment is owned by more than two Lessees. Do the other Lessees need to sign the Sales Contract?

Yes, all Lessees (buyers) need to sign the Sales Contract. You should use a form that we have to list the required information for additional buyers and attach it to the Sales Contract. There is a box to check on the Sales Contract after the section for the second name. Please check the box when you are completing the additional form.

63. I am planning to sell my leasehold apartment soon. Will the lease-to-fee conversion present a problem?

You are free to sell the leasehold apartment. The new buyer may want to purchase the Leased Fee. This can be accomplished in two ways.

- A. Sell and close on the leasehold apartment now and then your purchaser can accept the Offer to purchase the Leased Fee. Remember, your purchaser will have the same deadline to accept the Offer and close.
- B. Sell the leasehold apartment subject to you buying the Leased Fee, accept the Sales Contract and assign the Sales Contract to your purchaser, and close on both transactions simultaneously. If you want your purchaser to have the opportunity to buy the Leased Fee, you may want to accept the Offer now. Discuss this matter with your agent or SRL's sales agent.

The important point is that the purchaser of the Leased Fee must be the lessee under the Sublease. Except as described in Question No. 64, your purchaser can close on the leasehold apartment before or simultaneously with the Leased Fee purchase, but your purchaser CANNOT close on the Leased Fee and buy the leasehold apartment later. Under the current lessee program, the leasehold apartment must be purchased prior to or simultaneously with the Leased Fee purchase.

64. Can the new buyer of the leasehold apartment purchase the Leased Fee and then buy the apartment later?

No (not under the current lessee program). The purchaser of the Leased Fee must be the lessee of record of the apartment or a buyer under an Agreement of Sale. If LT makes the Leased Fee available to 3rd party investors, the new buyer could purchase the Leased Fee first, then purchase leasehold apartment later.

65. If I am currently selling my leasehold apartment, should I adjust my asking price now that the Leased Fee is available for sale?

Now that the Leased Fee is available for sale, you can change your listing to reflect this – from Leasehold (LH) to Fee Available (FA). As far as whether or not any adjustment in price should be made, you should discuss this with your real estate sales agent. The important point to remember is

that there are deadlines to accept the Offer in the Sales Contract and to close. These deadlines will not be extended and your buyer would need to meet these deadlines to purchase the Leased Fee. You should work closely with your real estate sales agent to ensure these deadlines are not missed.

66. Can someone be added to title?

Yes. If you add someone on the leasehold apartment, the person must be a purchaser of the Leased Fee. You should be talking to your lender, tax consultant, etc., to see if there is an advantage to you doing this. If you need help with financing and you decide to make changes at the end of the closing process, you may be too late and miss the closing deadline. In such a case, you will not be able to purchase and your Sales Contract will be canceled (unless such deadline is extended and an extension fee is paid).

67. Our leasehold apartment is owned by a friend and me. I wish to buy the Leased Fee, but my friend does not want to buy. Can I buy the Leased Fee even though I am only half owner of the apartment?

No (not under the current lessee program). All owners of the leasehold apartment (all Lessees under the Sublease) must purchase the Leased Fee. You could buy out your friend and then own the leasehold apartment 100% and buy the Leased Fee. Or both of you may decide to sell now and let the new buyer of your leasehold apartment purchase the Leased Fee. If LT makes the Leased Fee available to 3rd party investors, you could purchase the Leased Fee first, then purchase leasehold apartment later.

68. What type of deed will be used to convey title to me?

It is customary in leased-to-fee conversions that the lessors convey the leased fee to lessees by way of a limited warranty deed with reservations and covenants.

69. What are LT's conditions to closing?

In addition to you paying the purchase price and signing the documents and otherwise performing under the Sales Contract, the Sales Contract is subject to the satisfaction of a number of conditions:

- A. The AOA waiving its 120-day Right of First Refusal.
- B. No default or lawsuit by the purchasing Lessee.
- C. The continuing authority of LT to sell.

70. Will I be assessed a monthly price increase if LT is not ready to close?

The monthly price increase only applies to delays caused by the lessee. If you have contracted, there will be no monthly price increase if a delay is caused by LT.

71. Can I assign my Sales Contract?

No assignment is allowed unless LT consents to the assignment. LT will consider consenting to an assignment of the Sales Contract to the purchaser of your leasehold apartment. See above for a discussion of this. You should give ample notice to SRL if you want to do this. We have a form if you are interested in assigning your contract. If there are Cooperating Brokers involved, they must agree on how the Cooperating Broker's commission, if any, will be paid and they must sign the assignment of Sales Contract.

72. What will happen if I am an out-of-state buyer or will be traveling when my purchase is ready to close?

You may wish to have a Power-of-Attorney prepared and recorded giving someone in Hawai'i the ability to sign for you. You should make sure the Power-of-Attorney is acceptable by escrow, title, and the Office of the Assistant Registrar of the Land Court.

If property is held in Trust, you may not be able to use a Power-of-Attorney, unless the trust documents specifically authorize the conveyance by way of a Power-of-Attorney. You should consult with your attorney to determine whether your trust documents allow for this.

73. The Sales Contract talks about the Project being “Dual System” and a part being registered with the Land Court. What does this mean?

This means that a portion of the land is registered with the Land Court and the balance of the land is not. Accordingly, each deed, mortgage, etc., must be recorded with (a) the Bureau of Conveyances and (b) the Office of the Assistant Registrar of the Land Court. Among other matters, the recording of such documents must comply with the requirements of the Land Court. If there has been a death, marriage, divorce, or name change of any Lessee, then you need to petition the Land Court to show those changes (if you have not done so already). Escrow will need original or certified documents (not Xeroxed copies) to petition the Land Court. If you have questions about these matters, please let us know.

74. What can we do to rush or expedite the Sales Contract?

It is important that the Sales Contract be filled out completely. Make sure you use your full legal name and no initials should be used. If your name has an initial only, you should put the initial in brackets followed by “(initial only).” Make sure that your phone number is correct and your address is complete. You should also furnish your email address. You should return the Sales Contract to us as soon as possible.

75. If there is something that you have said at the meeting or in these Questions and Answers that is different than what is in the Sales Contract, what controls?

The provisions in the Sales Contract would control. If there are any inconsistencies, please let me know so that the matter can be clarified.

SRL’S LENDERS LIST

Bank of Hawaii	Any loan officer	https://www.boh.com/loanofficers/
First Hawaiian Bank	Elina Grugier-Bell	532-9896; egrugier@fhb.com
	Grant Uyeno	781-4653; guyeno@fhb.com
Homestreet Bank	Judy Meredith	222-7903; judy.meredith@homestreet.com
Compass Home Loans	Crystal Acohido	349-3145; cacohido@compasshawaii.com
Territorial Savings	Roy Nakamura	487-1581; roy.nakamura@territorialsavings.net
Net Lending	Karl E. Baker	286-2754; karl@netlending.net

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complete list of all lenders, and you should check with whichever lender you want. You should start checking immediately.

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YOU SHOULD READ AND UNDERSTAND YOUR SALES CONTRACT
THE OPINIONS AND VIEWS AT THE MEETING AND IN THESE QUESTIONS AND
ANSWERS ARE THOSE OF SAVIO REALTY LTD., AND
SHOULD NOT BE ATTRIBUTED TO LILIPUOKALANI TRUST.