July 6, 2022

FOR INFORMATION

I. SUBJECT

Findings and recommendations of the Permitted Interaction Group ("PIG") established at the November 3, 2021, HCDA Kakaako Board Meeting, pursuant to Hawaii Revised Statutes 92-2.5(b), to examine the operations and management of the Honuakaha Limited Partnership ("HLP") relating to the Honuakaha Senior Rental Housing Project ("Project") located at 545 and 547 Queen Street, Honolulu Hawaii 96813 and Identified by TMK 1-2-031-021.

Partners in the HLP include:

- HCDA – General Partner (1%)
- First Hawaiian Bank – Limited Partner (99%)

II. BACKGROUND

The PIG was established on November 3, 2021, due to questions about the operation and management of HLP and the financial and non-financial impact such operations and management may have on the Project and HCDA in its role as the general partner of HLP.

The members of the PIG are Chair Susan Todani, Vice Chair Chason Ishii, Member Kevin Sakoda, and Member Philip Hasha.

III. DISCUSSION AND/OR ANALYSIS

The following documents were provided to the PIG.

1. HLP Agreements
2. HLP Audit Reports (2011-2020)
3. HLP Monthly Financial Reports (2017-2020)
4. HLP Reserve Study (2020)
5. HLP Tax Returns (2017-2020)
6. AOAO Honuakaha Agreements
7. AOAO Honuakaha Audit Report (2016 and 2017)
8. AOAO Honuakaha Monthly Financial Reports (2017-2020)
9. AOAO Honuakaha Reserve Study (2020)

The PIG convened on Thursday November 18, 2021, and discussed the history of the Project, current status, and future plans. The PIG requested additional revenue and expense data.

The PIG convened on Monday, February 14, 2022, and reviewed the additional revenue and expense data, discussed funding requests and opportunities, and developed a preliminary strategy for the management of the Project.

The PIG convened on Friday, May 20, 2022, and finalized the findings and recommendations to be shared with the Authority.

Findings:

1. Rent Increases: Rent increases are needed to cover increases in expenses, reduce operating losses and maintain an adequate reserve. The last rent increase was in 2013 and rent should have increased incrementally over time. As a result, an operating deficit developed. The deficit was also compounded by the installation of air conditioner in all units, which increased utility expenses.

   In January 2022, rents were increased for the first time in 9 years for existing tenants by 5%.

2. Operating Losses: The project is currently generating operating losses of about $200K to $460K annually.

3. Reserve Study: Reserve studies are needed to estimate the costs of repairing and replacing major components of the Project over time. The last reserve study was performed in 2001. As a result, large projects were not properly budgeted for.

   In August 2020, a reserve study was performed. It indicated that during that year about $240,000 was needed to be set aside by the AOAO during that year. This reserve amount needs to increase every year to enable the project to fund the estimated $3.48 million in needed future capital improvements.

Recommendations:

1. Increase Rent Annually: The PIG recommends the HCDA prepare a detailed budget every year and increase rent 5% annually.

2. Unit Turnover: Upon turnover of units, rents on new units are able to be increased to prevailing market rents which are substantially higher than current rents of existing tenants. However, higher rents are partially offset by a “turnover/releasing” period and any capital costs incurred to maintain units in preparation for new occupants.

3. Reserve Study: The PIG recommends the HCDA commission a reserve study bi-annually to ensure adequate funding of reserves, and associated budget requests.

4. Performance Metrics: The PIG recommends the HCDA develop, closely monitor and manage project operations based on a dashboard report which shows trends on a running monthly basis to include occupancy, net operating income, Section 8 statistics, unit turnover and receivables.

Final Comments:

1. The objective over the next two years will be to closely monitor the project performance, actively improve/stabilize cashflows and reduce the operating shortfalls.

2. The HLP was formed on December 3, 1993 and terminates on December 31, 2030. As in all real estate investments, it is prudent to revisit future strategy well in advance of the partnership termination date so that appropriate re-investment and operational decisions can be made. HCDA should revisit its strategy, which involves discussion with FHB, in 2024.

3. Loan Request: Despite the rent increase of 5%/year, given the expected continuation of operating shortfalls, supplemental funding will be needed – HCDA will requests funds annually for the subsequent fiscal year.

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Reviewed By: Craig Nakamoto, Executive Director ___________

Approved By:

Chair Susan Todani Susan Todani

Vice Chair Chason Ishii ______

Member Kevin Sakoda ______

Member Philip Hasha ______