

NOTE: Act 204, SLH 1982, changed the department name from Regulatory Agencies to Commerce and Consumer Affairs, effective June 10, 1982.

Any reference in title to Department of Regulatory Agencies shall be to Department of Commerce and Consumer Affairs.

TITLE 16

DEPARTMENT OF REGULATORY AGENCIES

CHAPTER 107

RULES RELATING TO HORIZONTAL PROPERTY REGIMES, CHAPTER 514A, HAWAII REVISED STATUTES

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SUBCHAPTER 1

GENERAL PROVISIONS

§16-107-1 Objective. These rules adopted by the real estate commission, hereafter referred to as "commission," are intended to clarify and implement chapter 514A, Hawaii Revised Statutes, to the end that the provisions thereunder may best be effectuated and the public interest most effectively served. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-45)

§16-107-2 Definitions. Definitions of terms found in section 514A-3, HRS, shall be adopted by reference. In addition, the following definitions shall be included:

"Apartment" means unit.

"Apartment owner" means unit owner.

"Administrative rules and regulations" means house rules.

"Certificate of occupancy" means and include the first certificate of occupancy or temporary certificate of occupancy issued for the structure or structures constructed on the project site.

"Determination", as used in section 514A-87(b), HRS shall include, but not be limited to, house rules.

"Disclosure abstract" means the abstract referred to in section 514A-6l, HRS.

"First conveyance" means and includes the initial transfer of title or equitable title from developer by way of deed, lease, assignment of lease or agreement of sale.

"Material respect" as used in section 514A-63, HRS means:

- (1) Any change in the use, size, construction materials or location of an apartment or any limited common element appurtenant thereto as determined by the commission;
- (2) Any addition, deletion, or change in the common elements which affects their size, use or construction materials as determined by the commission; or
- (3) Any change in the percentage of common interest, and any other change as determined by the commission.

"Offer for sale" means and includes any advertisement, inducement, solicitation of letters of intent to purchase, or any attempt of whatever nature to encourage any person to acquire any legal or equitable interest in any condominium unit. The method used in offering for sale shall include, but not be limited to, sales contracts, agreements of sales, reservation agreements, options to purchase, solicitation or acquiring of interested parties list whether general or specific, posting of signs indicating that the project is a condominium project, or giving of the selling agent's name or address or telephone number.

"Verified statement" means a sworn and notarized statement. [Eff 6/12/81;] (Auth: HRS §514A-45) (Imp: HRS §514A-45)

SUBCHAPTER 2

REQUIREMENTS FOR FILING HORIZONTAL PROPERTY REGIMES

§16-107-3 Filing of parking plan. If the parking stalls are designated as limited common elements, the developer shall submit with his notice of intention a definite parking assignment plan specifying the unit each parking stall is appurtenant to. The parking plan shall indicate whether each stall is a regular size and covered or uncovered. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-40(7))

§16-107-4 Filing of construction plan. Prior to the issuance of a final public report, the developer shall file with the commission a copy of the complete construction plan and attached thereto shall be a verified statement of a registered architect or professional engineer of this State certifying that the plan is an accurate copy of the plan as filed with and approved by the county or city and county officer having jurisdiction over the issuance of permits for construction of buildings. In lieu of the foregoing, the developer may submit a copy of the complete construction plan and attached thereto shall be a verified statement of a registered architect or professional engineer of this State that the plans fully and accurately depicts the layout, location, apartment numbers, and dimensions of the apartments as built. On an existing structure, the commission may accept a site plan, floor plan of each floor, and elevation plan and attached thereto shall be an as built certificate of a registered architect or professional engineer of this State. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-40)

§16-107-5 Method in computing percentage of common interest. At the time of filing the notice of intention, the developer shall submit a written explanation of the method of formula used in computing the percentage of common interest appurtenant to the condominium units. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §§514A-3(7), 514A-11(6), 514A-13(a) (b))

§16-107-6 Method of computing floor area. The floor area of the apartment or unit shall be computed and reported in the declaration and commission's public report as net living area. The net living area of the enclosed portion of the apartment shall be measured from the interior surface of the apartment perimeter walls. Areas of lanai or patio, which are considered as part of the apartment, shall be computed and reported separate from the enclosed apartment area. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-11(3))

§16-107-7 Escrow arrangement. Purchasers' monies received by an escrow prior to the issuance of a final public report shall be deposited in a

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trust fund with a bank, savings and loan association, or trust company authorized by the bank examination division, department of regulatory agencies, to do business under an escrow arrangement. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §§514A-65, 514A-67)

§16-107-8 Evidence of sufficient funds to complete the total project cost. Developer's statement of satisfactory evidence of sufficient funds as prescribed under section 514A-40(3), HRS, shall be a verified statement. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-40(3))

§16-107-9 Evidence of performance bond. In lieu of a performance bond of not less than 100 per cent of the construction cost called for in section 514A-49(5), HRS, the commission may accept an irrevocable letter of credit issued by a federally insured lending institution authorized by the bank examination division, department of regulatory agencies, committing funds for 100 per cent of the construction cost. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-40(5))

§16-107-10 Filing of disclosure abstract. At the time of filing the notice of intention, the developer shall submit a copy of his disclosure abstract, which will become an exhibit to the initial public report issued by the commission. The disclosure abstract shall be dated. In the event there occurs any change or changes to the information contained in the original disclosure abstract, the developer shall prepare and submit to the commission a copy of an amended disclosure abstract which shall be dated. It shall be the responsibility of the developer to provide to each prospective initial purchaser a copy of the original abstract and/or the amended abstract. Upon the issuance of the original and/or the amended abstract to each prospective initial purchaser by the developer or its sales agent, the prospective initial purchaser shall execute a dated receipt of the original and/or amended abstract. Receipts taken shall be kept on file in possession of the developer subject to inspection at any reasonable time by the commission or its authorized representative for a period of three years from the date the receipt was taken. [Eff 6/12/81] (Auth: HRS §§514A-45, 514A-61(c)) (Imp: HRS §514A-61)

§16-107-11 Filing of other documents. The commission may require filing of other documents, papers, data and information to complete the condominium registration file. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-39)

§16-107-12 (Reserved)

§16-107-13 (Reserved)

§16-107-14 (Reserved)

§16-107-15 (Reserved)

SUBCHAPTER 3

PUBLIC REPORTS

§16-107-16 Copies of public reports. Five copies of each public report shall be furnished the developer by the commission at no charge; if additional copies are necessary, they will be secured by the developer at his expense. Copies of the public report shall be of the color prescribed by the commission. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-42)

§16-107-17 Public report not to be represented as approval of project. A developer shall not make any representations to cause or lead a prospective purchaser to believe that the commission's public report is an approval of a project. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-36)

§16-107-18 Issuance of public reports to purchasers and prospective purchasers. Copies of all public reports issued for the project shall be given to purchasers and prospective purchasers of a unit in the condominium project in a sale of such unit by the developer after a cancellation of an original sale or the repossession of such unit as in the case of an original sale of such unit; this requirement shall equally apply to a sale subsequent to any sham or collusive sale by the developer designed to avoid the giving of such reports. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-62)

§16-107-19 Expiration of public reports. Sales contracts executed during any period the commission's most recent public report is not in effect may be rescinded at the option of the purchaser and all monies refunded to purchaser. Purchaser's right to rescind contained in this rule shall be voided thirty calendar days after receipt of written notification of his rescission rights from the developer or his agent. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §§514A-31, 514A-43)

§16-107-20 Offer for sale to nonowner-occupant. Developers, agents, or developer's representatives are prohibited from making any offer for sale of residential units to a nonowner-occupant prior to issuance of the commission's preliminary or final public report for the project. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-31)

§16-107-21 (Reserved)

§16-107-22 (Reserved)

SUBCHAPTER 4

ADVERTISEMENTS

§16-107-23 Filing of advertisement materials. Circulars, prospectus, brochures, pamphlets, leaflets, and all other advertising and promotional material on the condominium plan or project shall not be issued, circulated or published before a copy thereof shall have been previously filed with the commission. Such filing shall not be construed to mean an approval by the commission of the advertising and promotional material. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-68)

§16-107-24 Use of public report for advertising. The commission's public report shall not be used for advertising purposes unless the report is used in its entirety. No portion of the report shall be underscored, italicized, or printed in larger or heavier type than the remainder of the report, unless the true copy of the report furnished by the commission so indicates. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-42)

§16-107-25 Publication of announcement. The publication of announcement called for under HRS §514A-102 shall be published not less than two days per week in two successive weeks. [Eff 6/12/81] (Auth: HRS §514A-45) (Imp: HRS §514A-102)

§16-107-26 (Reserved)

§16-107-27 (Reserved)

SUBCHAPTER 5

REQUIREMENTS FOR OWNER-OCCUPANT SALES

§16-107-28 Sales exempt from owner-occupant requirements. Residential condominium projects built in a county zoned or designated hotel and resort areas shall be exempt from the provisions of Part VI, Sales to Owner-Occupants, of chapter 514A, HRS. Residential condominium projects situated in Waikiki shall not be exempt from the provisions of Part VI, Sales to Owner-Occupants, of chapter 514A, HRS. [Eff 6/12/81] (Auth: HRS §514A-45, 514A-107) (Imp: HRS §514A-101(2))

§16-107-29 Filing of copy of newspaper announcement and proof of publication. The developer shall file with his notice of intention a copy of the newspaper announcement and proof of publication of announcement in the form of an affidavit from the newspaper agency or company. The affidavit shall contain the dates announcements appeared in the newspaper. [Eff 6/12/81] (Auth: HRS §§514A-45, 514A-107) (Imp: HRS §514A-102)

§16-107-30 Filing of specimen copies of forms. The developer shall file with his notice of intention a specimen copy of the following forms which he proposes to use in connection with sales of residential units to owner-occupants:

- (1) Affidavit of intent to become an owner-occupant of a residential unit;
- (2) Reservation agreement between developer; and
- (3) Sales contract between owner-occupant and developer.

In addition to the above specimen forms, developers converting existing residential units to residential condominium units shall submit a specimen copy of the ninety-day notice to the existing tenants. The ninety-day notice shall contain notice of tenants first right of refusal to purchase the unit occupied by tenant prior to conversion. [Eff 6/12/81] (Auth: HRS §§514A-45, 514A-107) (Imp: HRS §§514A-104(1), 514A-105)

The Real Estate Commission adopted the rules relating to horizontal property regimes on November 21, 1980 following a public hearing held on October 30, 1980. The announcement for the public hearing was published in the Honolulu Star-Bulletin and Advertiser on October 5, 1980.

Chapter 107 of Title 16, Rules Relating to Horizontal Property Regimes of the Real Estate Commission, shall take effect ten days after filing with the Office of the Lieutenant Governor.

/s/ George A. Morris
GEORGE A. MORRIS, Chairman
Real Estate Commission

APPROVED AS TO FORM: Date 5/12/81

/s/ Randall Y. Iwase
Deputy Attorney General

APPROVED: Date 5/27/81

/s/ Mary G. F. Bitterman
MARY G. F. BITTERMAN
Director of Regulatory Agencies

APPROVED: Date 6/1/81

/s/ George R. Ariyoshi
GEORGE R. ARIYOSHI
GOVERNOR OF HAWAII

June 2, 1981
Filed

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Amendment to Chapter 16-107
Hawaii Administrative Rules

October 28, 1994

SUMMARY

A new subchapter 6 (§§16-107-61 through 16-07-75) is added.

SUBCHAPTER 6

REQUIREMENTS FOR REPLACEMENT RESERVES

§16-107-61 Objective. This subchapter implements the requirements of section 514A-83.6, HRS, that all condominium associations must follow budgets and establish statutory replacement reserves. These rules try to ensure that each owner in a condominium project pays a fair share of the short-term and long-term costs of operating the project, based on the owner's period of ownership. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-62 Definitions. Unless the context clearly indicates otherwise, the definitions in chapter 514A, HRS, apply to this subchapter and the following definitions apply to chapter 514A and this subchapter:

"Asset" means any part of the association property.

"Association property" means those parts of a condominium project which an association is obligated to maintain, repair, or replace, including but not limited to:

- (1) All of the common elements of the project, as determined from the project's declaration and the bylaws of the association and any master deeds, restrictive covenants, apartment deeds, apartment leases, or other documents affecting the project;
- (2) Any real property which is not part of the common elements but which the association either owns or leases for a term of more than one year, such as a manager's apartment acquired by the association after the project was developed;
- (3) Any personal or movable property owned or leased by the association; and
- (4) Any fixtures owned or leased by the association.

"Association property" does not include any part of the project which is "exempt association property" or which fewer than all owners are obligated to maintain, such as apartments or certain limited common elements.

Example:

A condominium association's documents state that a deck is a limited common element assigned to less than all of the owners. The documents also state that the owners of the apartments to which the deck is appurtenant must pay for the cost of maintaining and repairing the deck. Therefore

the association need not set aside funds for replacement reserves for the deck.

"Budget year" means the association's fiscal year for accounting and budgetary purposes.

"Contingency reserves" means all reserve funds, other than replacement reserves, in an association's reserves accounts, including but not limited to reserves for:

- (1) Unexpected contingencies or emergencies which, in the reasonable judgment of the board, may occur;
- (2) The payment of insurance deductibles or other expenses relating to insurance;
- (3) Legal expenses and lease renegotiation or fee purchase expenses;
- (4) Exempt association property or additions and improvements to the association property, such as new construction; or
- (5) Late payment or non-payment of an assessment by any owner.

"Emergency" means the same as "emergency situation," defined in section 514A-83.6(j), HRS.

"Estimated age" means the estimated useful life of an asset minus its estimated remaining life.

"Estimated remaining life" means any period: (1) which is shorter than the estimated useful life of an asset; and (2) for which the asset will continue to serve its intended function without requiring capital expenditures or major maintenance.

"Estimated replacement reserves" means funds which an association's reserve study indicates must be assessed and collected during a budget year to establish a full replacement reserve for the association by the end of that budget year.

"Estimated useful life" means the period of time a new asset, or an existing asset which has been newly restored or refurbished, will serve its intended function without requiring capital expenditures or major maintenance.

"Exempt association property" means any asset which:

- (1) At the end of its estimated useful life will require capital expenditures or major maintenance of less than \$1,000 or less than 0.1 per cent of the association's annual operating budget, whichever is greater; or
- (2) Has an estimated remaining life of more than twenty years.

Any asset which because of the passage of time ceases to be exempt shall become association property and be subject to the transitional rules stated in section 16-107-71.

"Existing association" means an association which has held its first association meeting before January 1, 1993.

"Full replacement reserve" means reserve funds for an asset equal to:

The projected capital expenditure or major maintenance required for the asset at the end of its estimated useful life; multiplied by a fraction which has as its numerator and denominator the asset's estimated age and estimated useful life, respectively.

The total of the full replacement reserves for each asset shall be a full replacement reserve for the association.

Example:

A roof with an estimated useful life of ten years will cost \$100,000 to replace. At the end of its seventh year of life, a full replacement reserve will be $\$100,000 \times 7/10 = \$70,000$. In the tenth year of its life, a full replacement reserve will be $\$100,000 \times [10/10 = 1] = \$100,000$.

"Funds" or "reserve funds" means cash or cash equivalents but excluding any funds which the association has borrowed. No borrowed funds shall be included when calculating whether an association has collected its statutory replacement reserves.

"Managing agent" means, for purposes of the good faith exemption provided by section 514A-83.6(d), HRS, any person who prepares a replacement reserve study and who:

- (1) Is a managing agent as defined by chapter 514A, HRS, and commission rules and policies relating to managing agents;
- (2) Meets all legal requirements for managing agents; and
- (3) Is the managing agent for the association for which the reserve study is prepared.

Any employee of a managing agent who prepares the replacement reserve study shall be deemed a managing agent for purposes of this definition.

"Minimum replacement reserve" means fifty per cent of a full replacement reserve.

"New association" means an association which holds its first association meeting on or after January 1, 1993.

"Statutory replacement reserves" means fifty per cent of an association's estimated replacement reserves.

"Substantially deplete" means any expense for an emergency which reduces the association's replacement reserves and contingency reserves by more

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than seventy-five per cent. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99)
(Imp: HRS §514A-83.6)

§16-107-63 Effective date for establishing statutory replacement reserves.

(a) The requirements of this section shall be subject to the transitional rules stated in section 16-107-64 and the emergency rules stated in section 16-107-67.

(b) Each budget year, beginning in the 1993 budget year, the board of an existing association shall prepare and adopt an annual operating budget for the following budget year. Each annual operating budget shall include assessments sufficient to fund the association's statutory replacement reserves for the year to which the budget relates. Each budget year, beginning with the 1994 budget year, the association shall assess and collect at least its statutory replacement reserves for that budget year.

(c) Each budget year, beginning in the year of a new association's first annual meeting, the board of the new association shall prepare and adopt an annual operating budget for the following budget year. Each annual operating budget shall include assessments sufficient to fund the association's statutory replacement reserves for the year to which the budget relates. Each budget year, beginning in the first budget year after the new association's first meeting, the association shall collect at least its statutory replacement reserves for that budget year.

(d) For those projects where the declaration has been recorded but the association has not held its first meeting by the later of either:

- (1) December 31, 1995; or
- (2) That date which is thirty-six months after the filing of the declaration,

then at least once each calendar year, commencing with the calendar year immediately following such later date, the developer shall, unless the developer owns one hundred per cent of the apartments in the project, notify in writing each apartment owner of the manner in which replacement reserves for future project maintenance and repairs are being addressed.

Such notice shall inform the owners in reasonable detail of at least the following:

- (1) The purpose for establishing replacement reserves;
- (2) A general summary of the replacement reserve requirements that would apply to associations under chapter 514A, HRS, and this subchapter, which held their first meetings before January 1, 1993, instead of after January 1, 1993, which general summary may be in such form as the commission may provide;

- (3) Whether any replacement reserve studies have been prepared for the project; and
- (4) The amount of replacement reserves, if any, being collected as part of the owners' maintenance fees, or otherwise being funded by the developer, and the manner in which those reserves were established. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-64 Transitional rules for full replacement reserves for existing associations prior to January 1, 2000. (a) Prior to January 1, 2000, an existing association shall collect at least fifty per cent of a full replacement reserve in its reserve account; and prior to the budget year beginning in 1997, an existing association shall collect at least twenty-five per cent of the amount which the association's replacement reserve study indicates will be a full replacement reserve for the association on January 1, 2000. Moreover, in the 1994 operating budget and in each succeeding annual operating budget prior to January 1, 2000, an existing association shall clearly disclose:

- (1) The dollar amount which the association's reserve study indicates will be a full replacement reserve for the association on January 1, 2000; and
- (2) How much of that amount the association intends to collect each budget year prior to January 1, 2000.

(b) In calculating a full replacement reserve for an existing asset, an association may disregard the actual age of the existing asset on January 1, 1994. Instead, the association may assume the estimated age of the existing asset on January 1, 1994 is zero and that the asset's estimated useful life is the same as its estimated remaining life on that date.

(c) An existing association whose budget year begins after January 1, 1993 may have up to six additional months beyond the dates given in this section to budget and assess for replacement reserves, provided the association collects fifty per cent of its full replacement reserves by January 1, 2000.

Example:

An existing association's reserve study indicates that a full replacement reserve for the association on January 1, 2000, will be \$200,000, so the law requires the association to have at least fifty per cent of that amount, the minimum replacement reserve, or \$100,000, by that date. If the association has no replacement reserve on January 1, 1994,

this section requires the association to fully disclose how much of the \$200,000 the association intends to collect each budget year prior to January 1, 2000. Moreover, the association must collect at least \$50,000 by January 1, 1997, and will have to collect sufficient funds thereafter to ensure the minimum replacement reserve is collected by January 1, 2000. The rule permits the association to collect \$50,000 during 1996 and \$50,000 during 1999, provided the association fully discloses its intent.

Example:

An existing asset which has an estimated useful life of thirty years, is already twenty years old on January 1, 1994, and has a replacement cost of \$100,000. Under the standard method of calculation, on December 31, 1994, a full replacement reserve for that asset would be \$70,000 ($\$100,000 \times 21/30$ - see the definition of full replacement reserve). If an association had not already established a replacement reserve for that asset, the amount required to establish a full replacement reserve by December 31, 1994, would be \$70,000. (Note, however, that to establish the minimum replacement reserve - fifty per cent of a full replacement reserve - would require only \$35,000). The estimated replacement reserves for each of the next nine years would be \$3,333 (\$30,000 divided by 9) to collect a full replacement reserve by the end of the year 2003, or fifty per cent of that amount (\$1,666) each year for statutory replacement reserves.

If the association adopts the method of calculation permitted by subsection (b), the full replacement reserve amount required by December 31, 1994, for the same asset would be only \$10,000 ($\$100,000 \times 1/10$), or \$5,000 for the minimum replacement reserve. Each subsequent year, however, the estimated replacement reserves will be \$10,000 (\$90,000 divided by 9) - higher than in the first example - because the method of calculation permitted by subsection (b) requires annual contributions to be higher to meet funding requirements. The statutory replacement reserves for each of the same nine years will be \$5,000.

[Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-65 Calculation of estimated replacement reserves; reserve study; good faith. (a) A board of directors of an association shall calculate the association's estimated replacement reserves based on a reserve study developed in compliance with this section.

(b) The board shall compile a list of the association's assets. If the project's declaration and association's bylaws fail to clearly state whether a particular part of a condominium project is association property, the board may adopt a resolution allocating responsibility for that part to the association, an individual owner, or individual owners. The board's resolution shall be based on chapter 514A, HRS, the project's declaration and the association's bylaws, and any other applicable legal requirements or documents. The resolution shall clearly indicate whether the part in question:

- (1) Is an asset of the association;
- (2) Is the responsibility of an individual owner or individual owners, but fewer than all owners; or
- (3) Is partly an asset of the association and partly the responsibility of fewer than all owners, such as plumbing or electrical system.

The resolution shall state the basis of the board's decision and shall be effective to determine responsibility for replacement reserves for the part in question upon adoption and until changed by the board or by an amendment to the declaration or bylaws.

(c) The board shall determine the estimated useful life of each asset, based on at least one of the following:

- (1) The association's past experience with the asset;
- (2) Any publication, such as the commission's Condominium Reserve Reference Manual; "Life Cycle Cost Data" (McGraw-Hill, New York); or "Repair & Remodel Quarterly" (Marshall & Swift, Los Angeles), which provides statistics of the estimated useful lives of items similar or comparable to the asset;
- (3) The estimate of any Hawaii licensed contractor or an authorized supplier for the asset, any item similar or comparable to the asset, or any materials or services for the asset's upkeep, repair, or replacement; or
- (4) Any warranty provided by the supplier, installer, manufacturer, or builder of the asset or any services relating to its installation, upkeep, repair, or replacement.

(d) The board shall calculate the estimated capital expenditure or major maintenance required for each asset, based on at least one of the following, adjusted for inflation:

- (1) The association's past experience with expenses relating to the asset;
- (2) Any publication, such as the commission's Condominium Reserve Reference Manual; "Life Cycle Cost Data" (McGraw-Hill, New York); or "Repair & Remodel Quarterly" (Marshall & Swift, Los Angeles), which provides statistics on the estimated capital expenditure or major maintenance, required for the asset or items similar or comparable to the asset; or
- (3) The estimate of any Hawaii licensed contractor or an authorized supplier of the asset, any item similar or comparable to the asset, or any materials or services for the asset's installation, upkeep, repair, or replacement.

(e) Each year, the board shall adjust the amount of the estimated replacement reserves for an asset based on reasonable projections for inflation and for interest which will be earned during the estimated useful life of the asset. Adjustments for inflation shall not assume an annual inflation rate less than that of the Honolulu Consumer Price Index for All Urban Consumers for the prior year. Adjustments for interest earned shall not exceed the prior year's average interest rate for Seven-Year United States Treasury Bills.

(f) If a board plans to assess less than one hundred per cent of the association's estimated replacement reserves for a budget year, the association's operating budget for that year, the reserve study, and the association's other records shall clearly and prominently indicate:

- (1) The total amount the association's replacement reserve study indicates will be a full replacement reserve for the association at the end of the current budget year; and
- (2) The total amount the association will have collected at the end of the current budget year.

(g) Any association, or any apartment owner, director, officer, managing agent, or employee of an association who calculates the association's estimated replacement reserves as provided in subsections (b), (c), (d), and (e) shall be deemed to have acted in good faith if the calculations subsequently prove incorrect; provided that an association board, director, officer, or managing agent must also make the disclosures required by subsection (f) to be deemed to have acted in good faith. [Eff 1/2/95 (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)]

§16-107-66 Fund accounting for each part of the association property; use of separate funds for other than stated purpose. (a) An association shall establish at least one reserve account for its replacement reserves. Within the replacement reserve account, however, the association shall establish a separate designated fund or funds for each asset for which estimated capital expenditures or major maintenance will exceed \$10,000. Replacement reserves for all assets for which estimated capital expenditures or major maintenance will not exceed \$10,000 may be aggregated into a single designated fund in the replacement reserve account.

(b) For each of the separate, designated funds, the association's records for the replacement reserve account shall state:

(1) The purpose of each fund or the asset for which it is established; and

(2) The amount of the replacement reserves allocated to each fund; provided, the association need not comply with paragraph (1) for the single, aggregated fund. Instead, the replacement reserve account records may state the purpose of the fund as "miscellaneous," or a similar term, and indicate the amount in the aggregated fund. Regardless, elsewhere in its records the association shall list the assets for which the aggregated fund is established.

(c) The association board shall use replacement reserves allocated to a particular fund only for the stated purpose of that fund, except:

(1) In an emergency or emergency situation the board may use the replacement reserves in any fund for any legitimate association purpose, provided the board passes a resolution containing written findings as to the necessity of using the replacement reserves for other than their designated purpose, the necessity of the expense involved, and why the expense was not or could not have been reasonably foreseen in the budgeting process, and the resolution shall be distributed to all members of the association; and

(2) The board may at any time use up to fifty per cent of the amount in any fund in the replacement reserves for the stated purpose of any other fund. In such a case, the association records, including but not limited to board meeting minutes, shall indicate the change in use of the fund and the dollar amount of the fund used for another fund, and the board need not comply with the procedures of section 514A-83.6(f), HRS, for notice to owners.

(d) If a board collects less than one hundred per cent of the association's estimated replacement reserves, the association's reserve account records shall clearly indicate how the board has allocated those reserves among

each of the separate, designated funds. The board may fund each of the designated funds by an equal percentage, fund them by varying percentages, or fully fund some and not fund others at all. Regardless of the option chosen, the reserve account records must accurately indicate the allocation of funds adopted by the board. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-67 Emergencies and emergency situations. (a) An association whose replacement reserves and contingency reserves have been substantially depleted by an emergency shall have three budget years to re-establish a minimum of fifty per cent of a full replacement reserve. The three years shall be calculated from the end of the budget year in which the association makes the payment which substantially depletes the association's replacement reserve.

(b) The board shall have the discretion to assess the owners in monthly, quarterly, or yearly installments to re-establish a minimum of fifty per cent of a full replacement reserve.

(c) In an emergency situation subject to section 514A-83.6(f), HRS, the board shall calculate the twenty per cent limit of that section based on the association's total annual operating budget for the budget year when the expense will occur. The board must notify the owners if an expense required because of an emergency situation will exceed the twenty per cent limit, but the board need not obtain owner approval for the expense. Prior to January 1, 2000, the board of an existing association shall not be subject to the twenty per cent limit.

(d) Section 514A-83.6(f), HRS, shall only limit a board's right to exceed its annual operating budget during the budget year to which the operating budget relates. The section shall not limit the board's right to increase an annual operating budget by more than twenty per cent over the annual operating budget of the previous year. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-68 Contingency reserves. Nothing in this subchapter shall prohibit the establishment of a contingency reserve in compliance with this section. Unless a project's declaration or an association's bylaws provide otherwise, the board of directors may establish a contingency reserve in an amount the board considers appropriate, based on: the age of the project; its maintenance history; plans for additions or improvements to the project; or any other factors the board deems relevant. The contingency reserve shall be subject to all the requirements relating to reserves except the requirements of sections

16-107-63, 16-107-64, 16-107-65, 16-107-66(c) and (d), 16-107-67, and 16-107-69. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-69 Conflict of chapter 514A, HRS, and this subchapter with association declaration or bylaw requirements. (a) Chapter 514A, HRS, and this subchapter shall override any contrary provisions in a project's declaration or an association's bylaws, or any other applicable documents regarding: preparation of budgets, calculation of reserve requirements, and assessment and funding of reserves. Except as stated in subsection (b), limits on spending or assessments shall not restrict the board's right to spend or assess for items required by the association's reserve study.

(b) Chapter 514A, HRS, and this subchapter shall not override any contrary provisions in a project's declaration, an association's bylaws or other applicable documents:

- (1) Requiring the board to collect more than the association's statutory replacement reserves;
- (2) Restricting a board's right to assess or spend to upgrade the common elements for such things as additions, alterations, or improvements; or
- (3) Requiring a board to repair or maintain assets more frequently than the law, this subchapter, or the association's replacement reserve study requires. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-70 Reserve funds non-transferable. Replacement reserve and contingency reserve funds which an association collects from apartment owners become the property of the association. An owner who sells an apartment shall have no right to reimbursement of the replacement reserve and contingency reserve funds from either the purchaser of the apartment or the association. The replacement reserve and contingency reserve funds shall not be conveyed or transferred separately from the apartment to which they relate. Instead, they shall be deemed conveyed or transferred with the apartment, even though they are not specifically mentioned in any conveyance, assignment, or transfer of the apartment. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-71 Exempt association property; disclosure; transition to association property. (a) The association's reserve study shall clearly disclose all assets for which funds are not included in the replacement reserve study because they are exempt association property. The reserve study shall also contain a brief explanation of why those assets are determined to be exempt association property.

(b) An asset which is deemed to be exempt association property because its estimated remaining life is more than twenty years shall become association property on the date its estimated remaining life becomes less than twenty years, referred to in this subsection as the transition date. The asset shall be included in the association's reserve study for the first budget year after the transition date. In calculating a full replacement reserve for the asset after the transition date, the association may disregard the asset's actual age. Instead, the association may assume that at the beginning of the first budget year after the transition date, the asset's estimated age is zero and its estimated useful life is the same as its estimated remaining life.

Example:

An existing asset has an estimated useful life of fifty years, becomes thirty years old on January 1, 2010, has an estimated remaining life of twenty years, and an estimated replacement cost of \$100,000. Under the standard method of calculation, a full replacement reserve on December 31, 2010, for that asset would be \$62,000 ($\$100,000 \times 31/50$). If an association had not already established a replacement reserve for that asset, the full replacement reserve contribution by December 31, 2010, would be \$62,000 (or fifty per cent of that amount - \$31,000 - for the minimum replacement reserve). If the association adopts the method of calculation permitted by subsection (b), the full replacement reserve contribution required by December 31, 2010, for the same asset would be only \$5,000 ($\$100,000 \times 1/20$), or fifty per cent of that amount - \$2,500 - for the minimum replacement reserve, although subsequent annual contributions will be higher than in the first example. In effect, the asset is deemed to be only one year old, not thirty-one years old on December 31, 2010. [Eff 1/2/95] (Auth: HRS §§ 514A-83.6, 514A-99) (Imp: §514A-83.6)

§16-107-72 Borrowing and special assessments to fund replacement reserves. Provided an association assesses and collects sufficient funds to comply with the law and these rules, the association board may:

- (1) Transfer funds between the separate, designated funds required by section 16-107-66, subject to the requirements of that section;
- (2) Borrow funds, subject to the requirements of section 514A-82.3, HRS; and
- (3) Specially assess the apartment owners;

to pay the cost to maintain, repair, or replace assets of the association. This section shall apply if the board underestimates the reserve requirements for an asset, or if the cost to maintain, repair, or replace an asset will reduce the association's replacement reserve funds to less than fifty per cent of a full replacement reserve during any budget year.

Example:

An association's full replacement reserve requirement is \$500,000, but the association has only \$250,000 of that amount in cash, as the law permits. The association's replacement reserve account designates \$200,000 of the \$250,000 to replace its roof in 2001 (i.e., after the transition period ends on January 1, 2000). In 2001, the association replaces its roof on schedule. If the association spends all of the \$200,000 designated in its replacement reserve account for the roof, large assessments will be necessary to re-establish fifty per cent of a full replacement reserve in cash by the end of 2001.

Replacing the roof will reduce the association's replacement reserve requirements during 2001 by \$200,000, from \$500,000 to \$300,000 (to which must be added, however, the funds required during 2001 for the other association assets). Nevertheless, spending the \$200,000 will also reduce the association's replacement reserve funds by \$200,000, from \$250,000 to \$50,000 (plus whatever the association collects during 2001).

Thus, by the end of 2001, the association will have only \$50,000 in reserves, but need at least \$150,000 (i.e., fifty per cent of its full replacement reserve requirements of \$300,000). Therefore, the association must collect at least

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\$100,000 by the end of 2001 to reach the minimum replacement reserve of \$150,000 (plus whatever else the reserve study indicates is necessary for other assets).

To reduce the hardship, the board can fund the expenses for the roof by borrowing or by special assessments. Even if the association has designated a specific fund in its replacement reserve account for the asset, the board may also transfer the money in that fund to other designated funds. Essentially, the section permits the board to use cash on hand, special assessments, borrowing, or any combination of the three to replace the roof and reduce the hardship on the owners. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-73 Leasing of association property. An association board may lease rather than buy property to repair or replace any association property. Property which meets the definition of association property shall be deemed an asset of the association and must be included in the association's reserve study, regardless of whether the association owns or leases the property. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-74 Distribution of budgets and reserve studies. An association board shall distribute the annual operating budget required by section 514A-83.6(a), HRS, at least thirty days before the date of the association's annual meeting. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §514A-83.6)

§16-107-75 Enforcement. If an association board fails to prepare an annual operating budget or replacement reserve study in compliance with the requirements of section 514A-83.6, HRS, or this subchapter, an association member may enforce those requirements. The association member may collect the costs of enforcement in compliance with the procedures provided in section 514A-94, HRS, including fees and costs incurred by the owner. If an arbitrator or judge determines that a board or board member has breached a fiduciary duty by intentionally ignoring the requirements of section 514A-83.6, HRS, or this subchapter, the judge or arbitrator may award the owner's fees and costs of

enforcement against the board or board members, rather than against the association. [Eff 1/2/95] (Auth: HRS §§514A-83.6, 514A-99) (Imp: HRS §§514A-82.4, 514A-83.6)

Amendment to chapter 16-107, Hawaii Administrative Rules, on the Summary page dated October 28, 1994, was adopted on October 28, 1994, following a public hearing held on September 6, 1994, after public notice was given in the Honolulu Advertiser, West Hawaii Today, Hawaii Tribune-Herald, The Maui News, and the Garden Islands on July 31, 1994.

This amendment shall take effect ten days after filing with the Office of the Lieutenant Governor.

/s/ Marcus Nishikawa
MARCUS NISHIKAWA, Chairperson
Real Estate Commission

APPROVED AS TO FORM: Date _____

/s/ Shari J. Wong
Deputy Attorney General

APPROVED: Date 12/9/94

/s/ Clifford K. Higa
CLIFFORD K. HIGA, Director
Commerce and Consumer Affairs

APPROVED: Date 12/22/94

/s/ Benjamin J. Cayetano
BENJAMIN J. CAYETANO
Governor
State of Hawaii

December 23, 1994
Filed