NATIVE HAWAIIAN LAND USE RIGHTS

AND

THEIR IMPACT ON REAL ESTATE LENDING IN HAWAII

by

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Executive Summary

This report examines the issues surrounding native land use rights in Hawaii. It seeks to determine their potential impact on real estate lending and the measures lenders should take in addressing this matter when considering development financing requests. It includes a synopses of issues raised in recent litigation and relates the opinions of various interested individuals and organizations. This report is not intended to evaluate the merits of the rights themselves, but rather, to inform the reader of their existence, describe their relevance to lenders, and to recommend courses of action to reduce lender exposure.

The sources of information included in this report were: books, magazines, journals, statutes, case law, and interviews with attorneys and financial services personnel.

The analysis of the information gathered revealed that:

- The existence of native land use rights is a fact of law.
- The definition and extent of these rights, as established through litigation, have grown in magnitude; yet contain considerable ambiguities which may effect a broad range of properties.
- The inability to obtain title insurance without exceptions for land use rights, may negatively effect the value of properties.
- Lenders should avoid reliance on the value of properties when title insurance without exceptions for native Hawaiian land use rights cannot be obtained.
- Lenders may face exposure on loans where title insurance coverage is not excluded.
- Lenders should review real estate lending guidelines and procedures in order to minimize the potential exposure arising from native land use rights.

TABLE OF CONTENTS

	Page
Executive Summary	ii
CHAPTER	
I. INTRODUCTION	1
II. THE EVOLUTION OF THE HAWAIIAN LAND SYSTEM	2
The Ancient Hawaiian Land System	2
The Reformation of the Land System	3
The Rights of Native Tenants	5
III. LITIGATION OF NATIVE LAND USE RIGHTS	7
Kalipi vs. Hawaiian Trust Company	7
Pele Defense Fund vs. Paty	8
The "PASH" Case	9
IV. THE PROBLEMS FACING LENDERS	11
Questions Left Unanswered	11
Ramifications	16
Discovery of Protected Rights	17
Title Insurance Exclusions	20
Exposure on Existing Loans	21
V. THE SOLUTION	23
VI. RECOMMENDATIONS	25
Review Existing Loans	25
Review Lending Guidelines	27
Actively Support Resolution	27

Bibliography.. 29

Interviews.. 30

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TABLE OF CONTENTS

Page

Executive Summary.................................... ii

CHAPTER

I. INTRODUCTION.................................... 1

II. THE EVOLUTION OF THE HAWAIIAN LAND SYSTEM.......... 2

The Ancient Hawaiian Land System............... 2

The Reformation of the Land System............. 3

The Rights of Native Tenants................... 5

III. LITIGATION OF NATIVE LAND USE RIGHTS............... 7

Kalipi vs. Hawaiian Trust Company.............. 7

Pele Defense Fund vs. Paty..................... 8

The "PASH" Case................................ 9

IV. THE PROBLEMS FACING LENDERS........................ 11

Questions Left Unanswered...................... 11

Ramifications.................................. 16

Discovery of Protected Rights.............. 17

Title Insurance Exclusions................. 20

Exposure on Existing Loans................. 21

V. THE SOLUTION.................................... 23

VI. RECOMMENDATIONS................................. 25

Review Existing Loans.......................... 25

Review Lending Guidelines...................... 27

Actively Support Resolution.................... 27

Bibliography... 29

CHAPTER I. INTRODUCTION

What is the significance of native land use rights to real estate lenders in Hawaii? This report examines the issues surrounding native Hawaiian land use rights by briefly tracing their origin, evolution through litigation, and potential impact to real estate lenders. It does not seek to weigh the merit of these issues. It is instead designed to inform the reader of their existence, contemporary concerns, and the hazards they pose to real estate lenders. Lastly, this report will recommend lending procedures and guidelines to minimize potential loss exposure in this area. This work is targeted to members of the lending community who have not previously dealt with these issues.

There is very little written that examines the contemporary issues that surround native land use rights in Hawaii. The information gathered in this report was gleaned from what published sources that are available, synopses of litigation relating to native land use rights, and interviews with members of the legal and financial services community and native Hawaiian advocate organizations.

CHAPTER II. THE EVOLUTION OF THE HAWAIIAN LAND SYSTEM

The Ancient Hawaiian Land System

The system of land ownership in effect in Hawaii, before the arrival of the first westerners in 1778, was feudal in nature. The Hawaiian form of government was monarchist; the ruling kings held the land and their subjects occupied it at the king's pleasure under an allodial system somewhat similar to the European feudal land system. Under this system, the king allotted a portion of his lands to his chiefs, who in turn made reallotments to the commoners. While these distributions were made on a revocable basis, it was understood that allotments and tenancy would not be revoked without cause. Tenancy on these lands carried with it the customary right to harvest products of the soil and ocean, as well as certain obligations to the landlord in return.

The allotment of lands by the king to his chiefs were usually made in the form of an *ahupua'a*,[1] the boundaries of which customarily extended from the mountains at the center

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[1] A Hawaiian word for a unit of land, the size of which can vary substantially.

of the island to the coastal waters below.[2] This structure was designed to enable the chief and his tenants to secure the various necessities of life. For example, the uplands provided tenants with fruit and materials for housing. The valleys were suited for cultivation of crops and fresh water fishing. The shoreline offered reef animals, ocean fishing, and seaweed. In this way, tenants enjoyed a balanced diet and had access to other materials necessary for existence.

The Reformation of the Land System

The reign of King Kamehameha I in the early nineteenth century saw the consolidation of all the islands under one ruler. The advent of the whaling, fur and sandalwood industries soon began to attract a growing number of foreigners to the islands. With the development of these industries, as well as the arrival of Western missionaries, pressure was put on the monarchy to change the existing system of land tenancy into one in which fee simple title could be held. The government recognized that if the

[2] Paul F. Nahoa Lucas, A Dictionary of Hawaiian Legal Land-Terms, Honolulu: Native Hawaiian Legal Corporation and University of Hawaii Committee for the Preservation and Study of Hawaiian Language, Art and Culture, 1995, p. 4.

Hawaiian economy was to grow and prosper, the land system would have to be reformed.

Beginning with the enactment of the Bill of Rights in 1839[3] and culminating with the passage of the Mahele[4] in 1848 and the Legislative Acts of July 10, 1850 and August 6, 1850,[5] the ancient Hawaiian system of land tenure was changed. The new system established the means by which the king's subjects could obtain title to their lands. Essentially, all of the lands of the islands were divided into three groups of ownership:

1) The king's or "Crown" lands.

2) The chiefs' or *Konohiki*[6] lands.

3) Government lands.

Commoners were given a mechanism by which they could present claims to a land commission in order to obtain title to their *kuleanas*.[7] While the process permitted tenants to obtain title to the lands they occupied, it did not address the need to access and forage on the *ahupua'a* in which their *kuleanas* were located as they had done in the past.

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[3] Jon J. Chinen, The Great Mahele, Honolulu: University of Hawaii Press, 1958, p. 7.
[4] A Hawaiian word meaning division.
[5] Nahoa Lucas, p. 12.
[6] A Hawaiian word meaning land agent.
[7] A Hawaiian word meaning a small area of residential or agricultural land.

THE RIGHTS OF NATIVE TENANTS

In dividing up his lands, Kamehameha III, his advisors and chiefs realized that provision had to be made for the continuation and protection of the traditional rights of native tenants to gather wildlife and harvest products of the soil and ocean to supplement their subsistence. Native tenants were seldom able to gather or cultivate everything that was necessary for their existence within their own *kuleanas*. As a result, it was the accepted tradition that tenants had the right to forage beyond the boundaries of their own *kuleanas*. The earliest written provision for the protection of these rights appeared in *The Declaration of Rights and the Laws Regulating Property in Hawaiian for these Hawaiian Islands*, promulgated by Kamehameha III in 1840.[8] In this document, "gathering practices were established for both the uplands as well as the sea."[9] Over the years, native Hawaiian gathering[10] rights have been further acknowledged and supported by the Hawaii Revised

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[8] See original document at Hawaii State Archives, Department of Accounting and General Services, Hawaii State Archives, Kekauluohi Building, Iolani Palace Grounds, Honolulu.
[9] Melody McKenzie, Native Hawaiian Rights Handbook, Honolulu: University of Hawaii Press, 1991, p. 224.
[10] The issue of *gathering rights* is a part of the larger issue of *land use rights*. The latter encompasses all manner

Statutes, sections 1-1 and 7-1, as well as Article XII, section 7 of the Hawaii State Constitution.

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of traditional and customary practices including religious practices.

CHAPTER III. LITIGATION OF NATIVE LAND USE RIGHTS

Three contemporary decisions by the Hawaii State Supreme Court have served to focus attention on certain divergent interests of landowners and native Hawaiians. These three landmark decisions cited and expanded existing state laws[11] supporting traditional native practices. In so doing, the court left a number of important questions unanswered. It is these questions that, remaining unanswered, pose significant problems for the real estate lending community.

Kalipi vs. Hawaiian Trust Company (Kalipi) - 1982

In this first significant case, the court affirmed the right of the lawful occupants of an *ahupua'a* to enter undeveloped lands within the *ahupua'a* for purposes of practicing native Hawaiian gathering rights. While the court cited specific items having to do with housing materials and fuel that native Hawaiians were permitted to gather, it left the door open for the expansion of those items. However, the court also sought to balance the

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[11] *Hawaii State Constitution*, Article XII, section 7 and *Hawaii Revised Statues*, sections 1-1 and 7-1.

interests of the landowner and the tenants so as to minimize harm to either party.

Pele Defense Fund vs. Paty (Pele) - 1990

In this case, the court expanded on the Kalipi case in that it affirmed the right of native Hawaiians to access properties beyond the boundaries of the *ahupua'a* in which they live for purposes of exercising "continuously exercised access and gathering rights necessary for subsistence, cultural or religious purposes."[12] In its ruling, however, the court failed to identify:

1) Who qualifies as a native Hawaiian?
2) Exactly what lands are subject to these rights?
3) Exactly what practices are the protected?
4) What is the necessary proximity, if any, of the claimant's residence to the property to be accessed?

In short, the court left unanswered the questions of whom, what, and where.

[12] Access concerns expanded from merely gathering rights to the practice of cultural and religious traditions.

The "PASH" Case (PASH) - 1995[13]

In this most recent case, the court further expanded the rights of native Hawaiians to access certain lands. It also cited the unique nature of property titles in the state of Hawaii. The significant points relevant to lenders in this case are:

1) In contrast with Western principals of private property rights, fee simple title to property in Hawaii confers only a "limited property interest,"[14] It does not include the right to universally exclude others from the owner's property.
2) During the entitlement process, each approving governmental agency is compelled to consider the potential effect on native Hawaiian land use rights for each development request.
3) The scope of properties that may be subject to these protected practices was expanded from

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[13] The complete name of this case is *Public Access Shoreline Hawaii and Angel Pilago vs. Hawaii County Planning Commission and Nansay Hawaii, Inc.,* No. 15460 Certiorari from the Intermediate Court of Appeals (Hawaii), Civ. No. 90-293K, 1995.

[14] Roy A. Vitousek III, "Hawaiian Rights Face the Rule of Western Law," The Honolulu Advertiser, September 17, 1995, p. B4.

"undeveloped" to those that are "less than fully developed."[15]

4) **Access and land use rights cannot be abandoned or lost through non-use.[16]**

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[15] **Ibid.**

[16] **James K. Mee, "Impact of the *PASH* Decision," Presentation to Judiciary History Center, February 16, 1996, p. 2.**

CHAPTER IV. THE PROBLEMS FACING LENDERS

Questions Left Unanswered

Up to now, the court has resolved only the specific issues brought before it. In answering the immediate concerns of the various parties, the court often left important logistical and interpretive ambiguities to be addressed as they arise in future actions.

To date, the most significant questions left unresolved are:

1) Who has these protected rights? In Pele, the dilution of the requirement that native claimants must have residency in the subject *ahupua'a*, leaves open the possibility that Hawaiians and others living anywhere may seek access, as long as the practice itself is traditional and customary. In PASH, the court reserved protection for "descendants of native Hawaiians who inhabited the islands prior to 1778"[17] and specifically declined application of any sort of blood quantum test. Yet

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[17] See *Public Access Shoreline Hawaii and Angel Pilago vs. Hawaii County Planning Commission and Nansay Hawaii, Inc.*, Opinion of the Court by Klein, J., Supreme Court of the

it also indicated, without elaborating, that certain non-Hawaiians may have protected rights, including "descendants of citizens of the Kingdom of Hawaii who did not inhabit the islands before 1778."[18]

2) <u>What practices are protected</u>? In its findings, the court cited the Hawaii State Constitution in confirming that the state "shall protect all rights, customarily and traditionally exercised for subsistence, cultural and religious purposes."[19] While it maintained that landowners could exclude "persons pursuing non-traditional practices or exercising otherwise valid rights in an unreasonable manner,"[20] the court failed to catalogue exactly what rights were valid. The court only determined that the practices had to have been established before November 26, 1892 and

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State of Hawaii, No. 15460 Certiorari from the Intermediate Court of Appeals (Hawaii), Civ. No. 90-293K, p. 50.

[18] Mee, p. 2.

[19] *Hawaii State Constitution*, Article XII, section 7, p. 152.

[20] See *Public Access Shoreline Hawaii and Angel Pilago vs. Hawaii County Planning Commission and Nansay Hawaii, Inc.*, p. 34.

that specifics "would depend upon the particular circumstances of each case."[21]

The task of identifying traditional practices is made more difficult by the fact that traditions and customs varied from place to place. Historically, a given practice that Hawaiians freely exercised in one *ahupua'a* may have been closely controlled or prohibited in another.[22] The variance in practices stems from factors, such as, what plants and animals existed where, and in what quantities, the personal reservations, or *kapu*,[23] of an *alii*,[24] or the religious significance of an area.

3) <u>What properties are subject to native rights?</u>

Broadening the scope of properties subject to native rights, the PASH decision stated, "We choose not to scrutinize the various gradations in property use that fall between the terms *undeveloped* and *fully developed*."[25] Once again, the

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[21] Ibid., p. 24.
[22] McKenzie, p. 224.
[23] A Hawaiian word roughly meaning prohibited.
[24] A Hawaiian word meaning chief.
[25] See *Public Access Shoreline Hawaii and Angel Pilago vs. Hawaii County Planning Commission and Nansay Hawaii, Inc.*, p. 34.
[25] Ibid., pp. 54-55.

court preferred to leave latitude for case by case considerations. As it now stands, a property can be developed to some extent and still be subject to those rights.[26] But to what extent was not addressed. For instance, would agricultural lands be considered fully developed; or a six-acre parcel containing a single family residence? Factors such as the size, location, or the magnitude of improvements on a property, were not indicated.

4) Who has the burden of proof that protected practices historically existed on a particular property? Since the court ruled that the right to exercise traditional practices cannot be lost through non-use,[27] how does one determine if a property was utilized in the past and, therefore, remains subject to protected practices? In PASH, the landowner asserted that evidence of usage of the practice in question only extended back as far as 1920 and, therefore, would not qualify for

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[26] **Janice Otaguro, "Islander of the Year - Mahealani Pai", Honolulu Magazine, January, 1996, pp. 62-69.**

[27] **See *Public Access Shoreline Hawaii and Angel Pilago vs. Hawaii County Planning Commission and Nansay Hawaii, Inc.*, p. 34.**

[27] **Ibid., p. 53.**

protection as an established Hawaiian usage. Unfortunately, this assertion was not addressed in the court's ruling. Since ancient Hawaiians lacked a written language, traditions and customs were communicated orally and through practice from generation to generation. Would the oral testimony of native Hawaiian practitioners be sufficient evidence? Or would a landowner face the daunting task of attempting to prove that a practice did not historically exist?

5) How are disputes between property owners and native Hawaiians to be reasonably resolved? The PASH justices acknowledged that conflicts between the Western concept of private property and traditional Hawaiian land usage rights, could "theoretically lead to disruption."[28] While the court affirmed the State's power to impose restrictions on the exercise of customary practices, no actual mechanism for the resolution of disagreements over the existence, or manner of exercise, these rights was suggested. Attorney James K. Mee noted

[28] Vitousek III, p. B4.

> "It is clear that, from now on, such potential traditions and customs must be considered any time a landowner seeks a permit to use or develop his or her property. A more difficult scenario is posed, however, if persons simply come on the land to engage in various practices. If the landowner attempts to expel the persons or prohibit the practice, the landowner could potentially be sued for violation of the practitioners' rights. However, if the landowner does nothing, the landowner may later be deemed to have acquiesced in the practice, even if it did not originally qualify as being 'traditional and customary'."[29]

Ramifications

The uncertainties arising from the PASH and other cases effect not only landowners and native Hawaiians, but also the many businesses, professionals and governmental agencies that serve them. Those having the largest stake in the resolution of these issues are real estate development and sales organizations, title companies, attorneys, and lenders. It is to the last group that this study is addressed.

Discovery of Protected Rights

[29] Mee, p. 3.

The existence of Hawaiian usage rights in a property may be characterized as being an encumbrance. They may be compared to easements and rights of way which serve to limit the landowner’s rights in the property, are designed to protect the interests of other parties and are conveyed intact along with the title. A significant difference is that Hawaiian usage rights are not customarily recorded and made a matter of public record. This makes their discovery much more difficult.

Before agreeing to finance a real estate project, lenders need to ascertain the extent to which, if any, the proposed site is subject to protected Hawaiian practices. Since the value of undeveloped property is closely linked with its potential uses, any encumbrance which serves to limit those uses would most likely have a corresponding effect on its value. Therefore, the existence of Hawaiian usage of the property may have a significant negative effect on its market value. Depending on the scope of the usage, the nature and extent of improvements that do not conflict with or infringe upon that usage may be severely limited. In PASH, the threat of contested case hearings over the development’s impact on certain gathering practices was enough to derail the project. The court ruling caused the revocation of the previously issued development permit. The

prospect of a prolonged and costly process to obtain a new permit resulted in the developer scraping its plans.

The current reality is that there is no reliable method for determining the existence of protected Hawaiian practices in a given property. While the courts have affirmed the State's responsibility to protect, and the power to regulate, traditional Hawaiian practices, neither the State nor the courts have developed mechanisms to clearly identify them. The use of archaeological studies and cultural surveys may assist in determining the likelihood of their existence, but they are by no means conclusive. Rights claimants may not openly assert themselves until well into the development process, after the developer has invested considerable sums on planning, design and other work necessary in the entitlement process. As it now stands, a developer is left to proceed through the entitlement process with the risk that, at any stage of approval, an individual or organization may step forward to assert usage rights, thereby delaying or derailing the project.

In light of these ambiguities, there is the chance that, the State may feel obligated to protect natural resources where usage claims have not been asserted and may

never become an issue. Land attorney, Kenneth R. Kupchak characterized that,

> "a development may thus have to run the gauntlet of a dozen or more native-rights determinations at the county, state and federal levels. Each agency has its own unique limited perspective and level of expertise. No unifying set of rules exists. No priorities exist among the parameters in this maze of decisions."[30]

Even if ultimately approved, the additional time and expense incurred in addressing these issues and the settlement of any claims could impact the financial viability of the project.

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[30] Kenneth R. Kupchak, "Native-use Rights to Affect Permits," Pacific Business News, April 15, 1996, p. 14.

Title Insurance Exclusions

Normally, purchasers and lenders rely on title insurance to protect against the potential loss of value associated with third party claims against a property. Title companies have well-established procedures for evaluating their exposure to claims stemming from such things as the discovery of hazardous materials, defects in the previous conveyances of the title, encroachments and various other third party claims. But in the case of native land use, the difficulties in identifying potential rights claimants and researching a property's history of Hawaiian usage significantly impair their ability to evaluate their exposure to policy-holders' claims stemming from this issue. Title companies now selectively include exceptions in coverage for claims arising from native land use rights. This, of course, leaves the landowner and lender exposed to these risks. The exclusion of coverage not only denies these parties protection, but it may also impede the lender's ability to transfer exposure by selling the loan in secondary markets. On loans where coverage is excluded, lenders cannot warrant that the loan meets the underwriting requirements of federal agencies, such as the Federal Home Loan Mortgage Corporation and the Federal National Mortgage

Corporation, that purchase mortgages in the secondary market.

Lenders share the same difficulties as title companies in identifying which of the properties they presently hold as collateral may be subject to native use rights and potential diminution of value. Factors which pose a significant threat are:

- The absence of any comprehensive catalogue of protected Hawaiian practices.
- The difficulty in determining a property's history of Hawaiian usage.
- The fact that even properties that have already been developed to some extent remain subject to native use claims.
- The lack of a reliable process by which a landowner can cause the assertion or disclosure of protected practices in a particular property.

Exposure on Existing Loans

Lenders should also be aware that they may have some exposure on existing loans where title insurance coverage does not currently exclude Hawaiian usage rights claims.

Lenders may experience diminution of the value of collateral properties that may simply appear to have high potential for Hawaiian usage claims. In liquidation, prospective buyers may be reluctant to invest in a property with such obvious potential. Title insurance normally only provides coverage for the discovery of actual claims against a property; not their potential for existence.

CHAPTER V. THE SOLUTION

As it currently stands, the ambiguities of existing law pose considerable problems for Hawaii landowners and the businesses that serve them. In a recent attempt to resolve some of these problems, two bills[31] were introduced into the Hawaii Legislature which sought to establish specific procedures for the assertion of native land use claims and to eliminate many of the ambiguities that currently exist. The bills failed to gain comprehensive support in either house. According to some observers, their failure reflects legislators' anxieties over the conflict of two widely supported concerns:

- The preservation of Hawaii's unique culture.
- The continuity of the established practices of property and business interests.

The broad range of entities that have an interest in these issues necessitates a comprehensive solution to the problem. One in which all parties actively participate, have their needs addressed and have influence in the development of the solution.

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[31] See Hawaii State Senate Bill 8 and House Bill 1920; introduced during the 1996-97 sessions.

The first, and possibly most difficult, hurdle will be to establish who best represents, and has the support of, native Hawaiians. To date, no single Hawaiian organization can claim comprehensive support from the Hawaiian community. A likely prospect may be the Office of Hawaiian Affairs[32] (OHA). This organization was established by the Hawaii State Constitutional Convention in 1978 to receive and manage lands and personal property in trust for Hawaiians. OHA is directed by a board of trustees who are elected by the Hawaiian community during regular elections. While certain Hawaiian organizations do not recognize its constitutional mandate, OHA appears to have the broadest support of any Hawaiian organization so far. Once Hawaiian representation has been established, all interests can then come together to begin the process of designing a politically and functionally viable solution to this problem.

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[32] In recent resolutions by the Hawaii State Legislature (House Committee Report Nos. 197 and 276, H.D. 1 and Standing Committee Report No. 1384, March 25, 1997) the State Office of Hawaiian Affairs was identified as a possible representative for native Hawaiians.

CHAPTER VI. RECOMMENDATIONS

Review Existing Loans

Until these issues are resolved, lenders should take steps to reduce any exposure to losses stemming from native land use claims. Lenders can follow the lead of title companies which have already enacted procedures in an effort to identify properties which have the highest potential for claims.[33] Some title companies are now inspecting properties to see if they contain any attributes which might indicate Hawaiian usage. These attributes include:

- Undisturbed natural land characteristics.
- The presence of streams, waterfalls, ditches or standing water.
- Proximity to the shoreline.
- Significant vegetation such as fruit trees or endemic plants.
- Archeological sites including stone walls and platforms or other artifacts indicating ancient habitation or usage.

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[33] Procedures vary from company to company. No uniform set of guidelines have been adopted.

Size is also a factor. Some title companies automatically include exclusions for native land use rights on properties larger than one or two acres.

If lenders hold significant obligations secured by properties with these attributes and are relying heavily on the sale of the property as the source of repayment, they may wish to obtain a more comprehensive analysis from recognized authorities on Hawaiian culture such as Bishop Museum. If potential problems sites are discovered, lenders can then consider the options normally available to them in cases where eroding collateral value is a concern. The options, however, may be few since concerns over these issues have only recently gained momentum. Existing loan documents may not contain provisions designed to counter threats of this nature. Lenders may be limited to addressing these concerns as obligations come up for renewal.

Review Lending Guidelines

Lenders should also establish procedures and criteria to limit exposure when entertaining new real estate loan requests. The easiest and most obvious answer is to simply not lend in situations where title insurance excludes native land use claims. Any request to finance a property where title insurance coverage excludes this coverage, should be carefully evaluated with emphasis placed on sources of repayment other than sale of the property. This is clearly a case for *cash flow* lending, as opposed to *asset-based*. Of course, customary loan to value ratios or percentages of advance should also be adjusted in order to reduce exposure in these cases.

Actively Support Resolution

Finally, lenders should closely follow the development of issues and litigation regarding Hawaiian land usage. Lenders should also use their influence to encourage the unilateral discussion and resolution of these issues in a forum, which by its broad representation can win comprehensive endorsement. Until a solution is devised,

lenders face a considerable impediment to the growth and quality of their real estate loan portfolios.

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