
Management Audit of the Aloha Tower Development Corporation

A Report to the
Governor
and the
Legislature of
the State of
Hawai'i

Report No. 10-04
April 2010



THE AUDITOR
STATE OF HAWAII

Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai'i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. Financial audits attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. Management audits, which are also referred to as performance audits, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called program audits, when they focus on whether programs are attaining the objectives and results expected of them, and operations audits, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. Sunset evaluations evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. Sunrise analyses are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. Health insurance analyses examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. Analyses of proposed special funds and existing trust and revolving funds determine if proposals to establish these funds are existing funds meet legislative criteria.
7. Procurement compliance audits and other procurement-related monitoring assist the Legislature in overseeing government procurement practices.
8. Fiscal accountability reports analyze expenditures by the state Department of Education in various areas.
9. Special studies respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawai'i's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.



THE AUDITOR

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OVERVIEW

Management Audit of the Aloha Tower Development Corporation

Report No. 10-04, April 2010

Summary

This is the first audit of the Aloha Tower Development Corporation (ATDC) performed by the Office of the Auditor. Previously, the State Auditor conducted Special Study 79-4, *Evaluation of the Proposed Hawai'i World Trade Center* and Report No. 87-13, *Review and Analysis of the Aloha Tower Redevelopment Project*. Our 1987 review recommended that Chapter 206J, Hawai'i Revised Statutes (HRS), which established the corporation, be repealed.

The 2008 Legislature requested this audit in House Concurrent Resolution No. 245, House Draft 1, Senate Draft 1. The resolution asks for a financial, performance, and management audit of the corporation and specifically requests that the Auditor study three litigated cases and determine whether the corporation's enabling statute should be repealed or amended.

Since establishment of the corporation in 1981, almost every development it has undertaken has resulted in litigation. After four sets of litigation, it owes upwards of \$1.6 million in damages and settlements, and has paid over \$725,000 in attorneys' fees and costs. Burdened by litigation costs of over \$2.4 million and delays, the corporation is unlikely to succeed in redeveloping the Aloha Tower Project Area.

Moreover, after 30 years of effort, the corporation has managed to complete only one phase of its original mixed-use development plan—and that development, the Aloha Tower Marketplace, is struggling. Without its component parts, the marketplace generates far less than was expected and has been unable to realize its projected financial benefits for the State—over \$4 billion over 65 years. The marketplace was supposed to generate \$22.2 million from 1996 to 2001; in fact, it fell far short, paying the corporation only about \$4.8 million. Without a resolution to the parking-related litigation, completed surrounding development, or subsequent development plans, the corporation is unlikely to succeed in reversing the marketplace's poor performance.

Our audit also found that the corporation has made little progress in resolving problems we identified in 1987, including an inherent conflict between redevelopment of the project area and maritime uses, and the corporation's pursuit of unrealistic financing strategies. Moreover, the corporation has known since 1999 that its master plan and administrative rules are outdated, affecting its ability to accomplish its mission. Yet, the corporation shirked its responsibility to update its plan and rules by ignoring professional advice from two credible consultants. The events of 9/11 and their resulting harbor security and restrictions render commercial, residential, and hotel uses at the project area even less viable.

Even if its master plan were not obsolete, the corporation would not be able to execute it. The corporation does not have a strategic plan and relies instead on its



Yearly Activity Plans—a requirement of the Department of Business, Economic Development & Tourism—mission statement, and the 16 development objectives in its administrative rules as a long-term strategic plan. None of these meets the requirements of a strategic plan.

Finally, with little to show for its development efforts and no projects on the horizon, the corporation now justifies its existence with recently added harbor infrastructure improvement work, which has little to do with its core mission to develop the Aloha Tower Project Area. Despite the urgent need to carry out the harbors work, we conclude that the corporation's development expertise is limited, at best, and its ability to enter into public-private partnerships to provide DOT-Harbors additional sources of funding is not needed. Moreover, the law creating the partnership between the corporation and DOT-Harbors allows the redirection of funds from the corporation's net revenues to a fund for harbors development. This ability to redirect funds will not help the corporation achieve its core purpose and could potentially starve redevelopment of the Aloha Tower Project Area.

Recommendations and Response

We recommend that the corporation be abolished on June 30, 2011. Prior to the corporation's sunset and to allow an orderly transition of responsibilities, we also recommend that the responsibility for harbors improvements be restored to the DOT-Harbors.

Further, responsibility for the Aloha Tower Project Area should be shifted to the Hawai'i Community Development Authority, with its comparable functions and greater development powers, even as we recognize that the authority's redevelopment efforts have not been without controversy. Yet, with its successful completion of 34 projects as of 2007 and similar organizational structure, merger of the authority and the corporation would eliminate duplication between the two agencies. In the transfer of the corporation's redevelopment responsibilities, the authority would need to assume responsibility for the corporation's contractual rights and obligations and the almost \$7.7 million the corporation owes the DOT for lost revenues, and resolve the corporation's legal disputes and debts.

The corporation agreed with some of our findings but disagreed with our recommendations. The corporation responded that the audit condemns "the current board and staff who have tenures of five years or less for actions long past." The corporation misses the point—that it is the corporation's responsibility to effectively address constraints to redevelopment at the Aloha Tower Project Area—and attempts to deflect blame by saying that solutions to these constraints "will require political will and funding resources" without acknowledging its own failure to muster the support needed for redevelopment. The corporation provided information to clarify a number of points raised in our audit, which neither contradicts nor changes our findings and recommendations.

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A Report to the
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Submitted by

THE AUDITOR
STATE OF HAWAI'I

Report No. 10-04
April 2010

Foreword

This report is our first audit of the Aloha Tower Development Corporation. The 2008 Legislature requested this audit in House Concurrent Resolution No. 245, House Draft 1, Senate Draft 1, to study three litigated cases against the corporation and determine whether the corporation's enabling statute should be repealed or amended. We conducted this audit pursuant to Section 23-4, Hawai'i Revised Statutes, which requires the Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

We wish to express our appreciation for the cooperation and assistance extended to us by the Aloha Tower Development Corporation and others whom we contacted during the course of the audit.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

This is the first audit of the Aloha Tower Development Corporation (ATDC) performed by the Office of the Auditor. It was requested by the 2008 Legislature in House Concurrent Resolution No. 245, House Draft 1, Senate Draft 1. The resolution asks for a financial, performance, and management audit of the Aloha Tower Development Corporation and specifically requests that the Auditor:

1. Study three litigated cases against the ATDC, involving Honolulu Waterfront Limited Partnership, Aloha Tower Limited Partnership, and Kenneth H. Hughes, Inc.; and
2. Determine whether Chapter 206J, Hawai‘i Revised Statutes, relating to the Aloha Tower Development Corporation, should be repealed or amended.

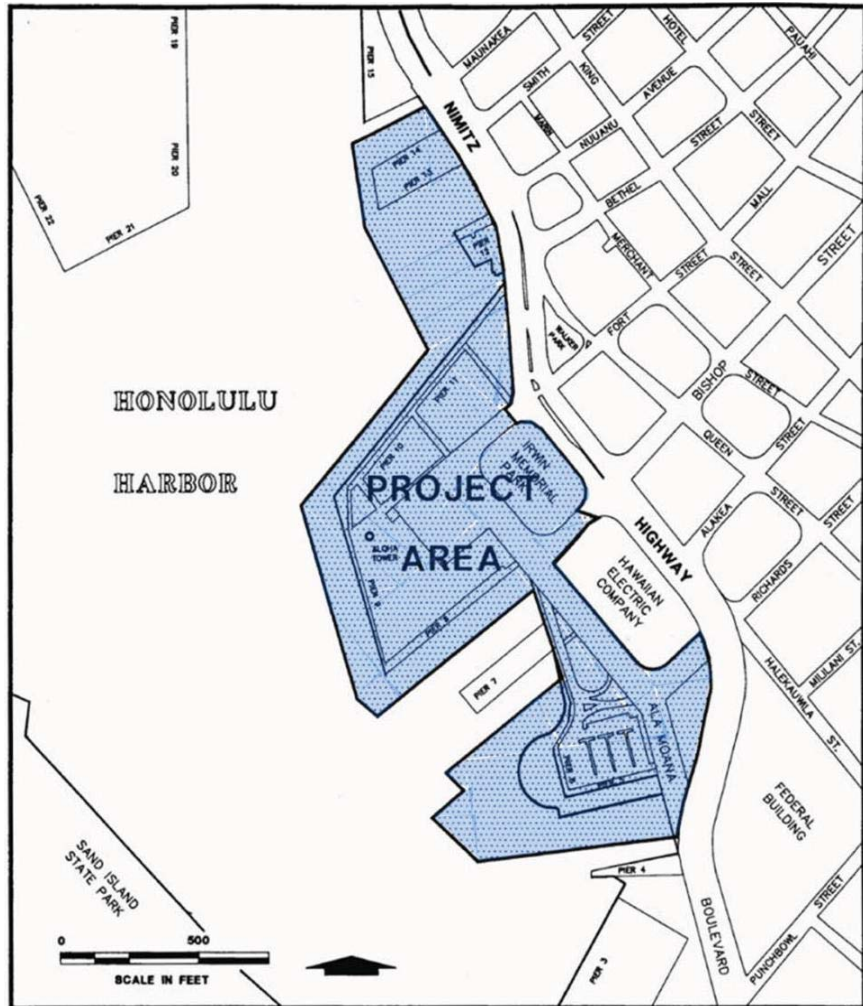
The State Auditor conducted this audit pursuant to Section 23-4, Hawai‘i Revised Statutes (HRS), which requires the Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

Background

Act 236, Session Laws of Hawai‘i (SLH) 1981, established the Aloha Tower Development Corporation as a public body corporate and instrumentality of the State. The corporation was created to undertake redevelopment of the Aloha Tower complex in Honolulu. The original 1981 complex was a 13-acre site between Piers 8 and 11 of Honolulu Harbor and includes the historic Aloha Tower. Expanded in both 1988 and 1990, the complex now encompasses Piers 5 through 23. When the tower was completed in 1926 it was the most imposing building in the Territory of Hawai‘i and the pride of the islands. For thousands of tourists arriving by ship, it was a symbol of welcome that was visible from 15 miles out to sea.

Redevelopment plans for the Aloha Tower complex cover a much smaller portion of the total site, known as the Aloha Tower Project Area. This area, located between Piers 5 and 14, is the primary focus of this report. Exhibit 1.1 shows the Aloha Tower Project Area.

Exhibit 1.1 Aloha Tower Project Area



Source: Map included in Title 15, Chapter 26, Hawai'i Administrative Rules, entitled *The Aloha Tower Complex: Project Area Rules*

Aloha Tower Project Area

The project area sits on land owned by the State of Hawai'i and controlled by the Department of Transportation-Harbors Division (DOT-Harbors). In 1993, DOT-Harbors leased the project area to the Aloha Tower Development Corporation for redevelopment.

Portions of the Aloha Tower Project Area sit on ceded lands—i.e., lands once under United States federal control that were returned to Hawai'i upon statehood, with conditions attached. Among the conditions is that revenues generated from the ceded land must be used for the betterment of Hawaiian people. Compliance with this requirement has evolved into

an annual payment to the Office of Hawaiian Affairs (OHA), which is paid by DOT-Harbors (not the corporation). DOT-Harbors paid OHA a total of \$6,230 in FY2008.

***Aloha Tower
Development
Corporation's mission
and purpose***

The corporation's enabling statute, Chapter 206J, HRS, states that the Aloha Tower complex is one of the most valuable properties in downtown Honolulu and that certain portions should be redeveloped or improved to better serve the people's economic, maritime, and recreational needs. The statute further states: "...the Aloha Tower complex still serves a vital maritime function that must be maintained to insure adequacy and viability for existing and future maritime activities." The corporation's purpose is to undertake redevelopment of the complex to:

1. Strengthen the community's international economic base in trade activities;
2. Enhance beautification of the waterfront;
3. Better serve modern maritime uses; and
4. Provide for public access and uses of the waterfront property.

The law envisions a properly developed Aloha Tower complex that stimulates commercial activities of the downtown business community and helps transform the waterfront into a "people place."

***The corporation's
organizational
structure and related
entities***

The Aloha Tower Development Corporation is administered by a board of directors. There are seven voting members: four ex officio members (directors of business, economic development & tourism, and of transportation; the chair of the Board of Land and Natural Resources, and the mayor of the City and County of Honolulu) and three public members, who are appointed by the governor for staggered terms.

Act 200, SLH 2008, increased the corporation's board by creating a subgroup called the Harbors Modernization Group. The group was established to undertake projects for the Harbors Modernization Plan, which consists of seven statewide harbor projects (Honolulu, Kalaeloa, Kahului, Hana, Hilo, Kawaihae, and Nāwiliwili) delegated to the corporation by the DOT. All projects must be approved by the director of transportation and the governor before the corporation may implement them. The Harbors Modernization Group is comprised of six voting members (the director of finance, two public members from the maritime industry, and the mayors of Hawai'i, Maui, and Kaua'i counties). The

corporation's board elects a chair from its members by a majority vote. The corporation's chair also serves as the chair of the Harbors Modernization Group.

The corporation's board appoints and sets the salary of the corporation's chief executive officer (CEO). The CEO serves at the pleasure of the board, is exempt from civil service, and is responsible for executing the board's policies, administering its affairs, and employing and supervising corporation staff.

In 2009 the corporation received approval to hire 18 employees to work for the Harbors Modernization Group, as shown in the corporation's organization chart at Exhibit 1.2. Corporation staff working for the Harbors Group are funded by the DOT. As of July 1, 2009, the ATDC had ten employees. Of those ten, only four employees had been hired to fill the 18 approved positions for the Harbors Modernization Group.

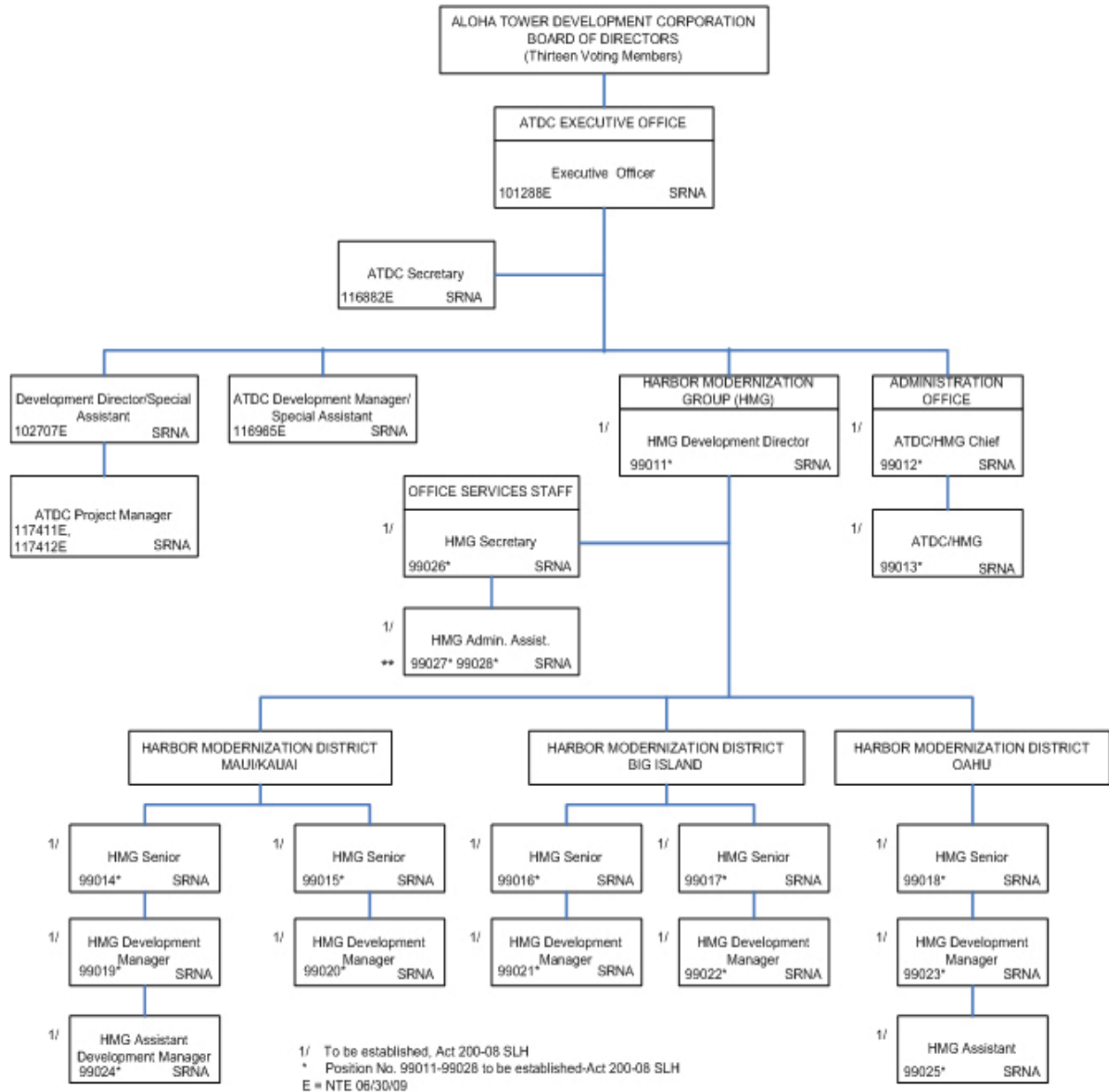
***Aloha Tower
Development
Corporation's financial
information***

The Aloha Tower Development Corporation's primary source of revenue is lease rent from the Aloha Tower Marketplace. The 65-year marketplace lease calls for a minimum of \$1 million base rent per year plus additional percentage rent, if applicable. The ATDC had not received any additional percentage rent from the marketplace lessee as of April 2009. The corporation's revenues and expenses flow through the Aloha Tower Fund, a special fund for the development, redevelopment, or improvement of the Honolulu waterfront.

The corporation must annually reimburse the DOT for any losses in revenues during the term of the lease caused by any action of the corporation or a developer, and to provide replacement facilities for maritime activities at no cost to the department. The first reimbursement owed to the DOT in 1993 was about \$1.1 million. The annual reimbursement was based on the assumption that all Aloha Tower development project components would be successfully completed and add to the corporation's revenues. The marketplace lessee, Aloha Tower Associates, was responsible for paying the annual reimbursement until its development agreement terminated in 1999. Without a development agreement in place, the corporation became responsible for payments starting in 2000. Effective July 1, 2004, future reimbursements were reduced to \$225,000 annually. Effective July 1, 2005, the reimbursement was reduced by the salaries of two corporation employees who performed harbors-related work. As of June 30, 2008, the corporation owed DOT approximately \$7.7 million for lost revenues.

Exhibit 1.3 shows the corporation's financial data for fiscal years 2005 through 2008. Amounts may not add, due to rounding.

Exhibit 1.2 Aloha Tower Development Corporation Organization Chart



** Reflects two HMG administrative assistant positions

September 24, 2008

Source: The Aloha Tower Development Corporation

Exhibit 1.3
Financial Data for the Aloha Tower Development Corporation,
FY2005 - FY2008

	FY2005	FY2006	FY2007	FY2008
Revenue	\$1,042,224	\$1,411,052	\$1,136,235	\$1,159,649
Expenses				
Expenditures	\$403,476	\$588,645	\$884,231	\$966,998
Current-Year Encumbrances	\$428,347	\$566,657	\$571,404	\$801,483
Transfer to General Fund (Act 52, Session Laws of Hawai'i 2004)	\$750,000	\$0	\$0	\$0
Total Expenses and Transfers	\$1,581,823	\$1,155,302	\$1,455,635	\$1,768,481
Net Revenue (Expenses)	\$(539,599)	\$255,750	\$(319,400)	\$(608,832)
Cash Reserve at Beginning of Year				
Carryover Cash Balance - Aloha Tower Fund	\$2,311,232	\$1,860,727	\$2,544,824	\$2,792,081
Prior Year-End Encumbrance	\$89,094	\$428,347	\$566,657	\$571,404
Total Cash Reserve at Beginning of Year	\$2,400,326	\$2,289,074	\$3,111,481	\$3,363,485
Cash Reserve at Year End	\$1,860,727	\$2,544,824	\$2,792,081	\$2,754,653

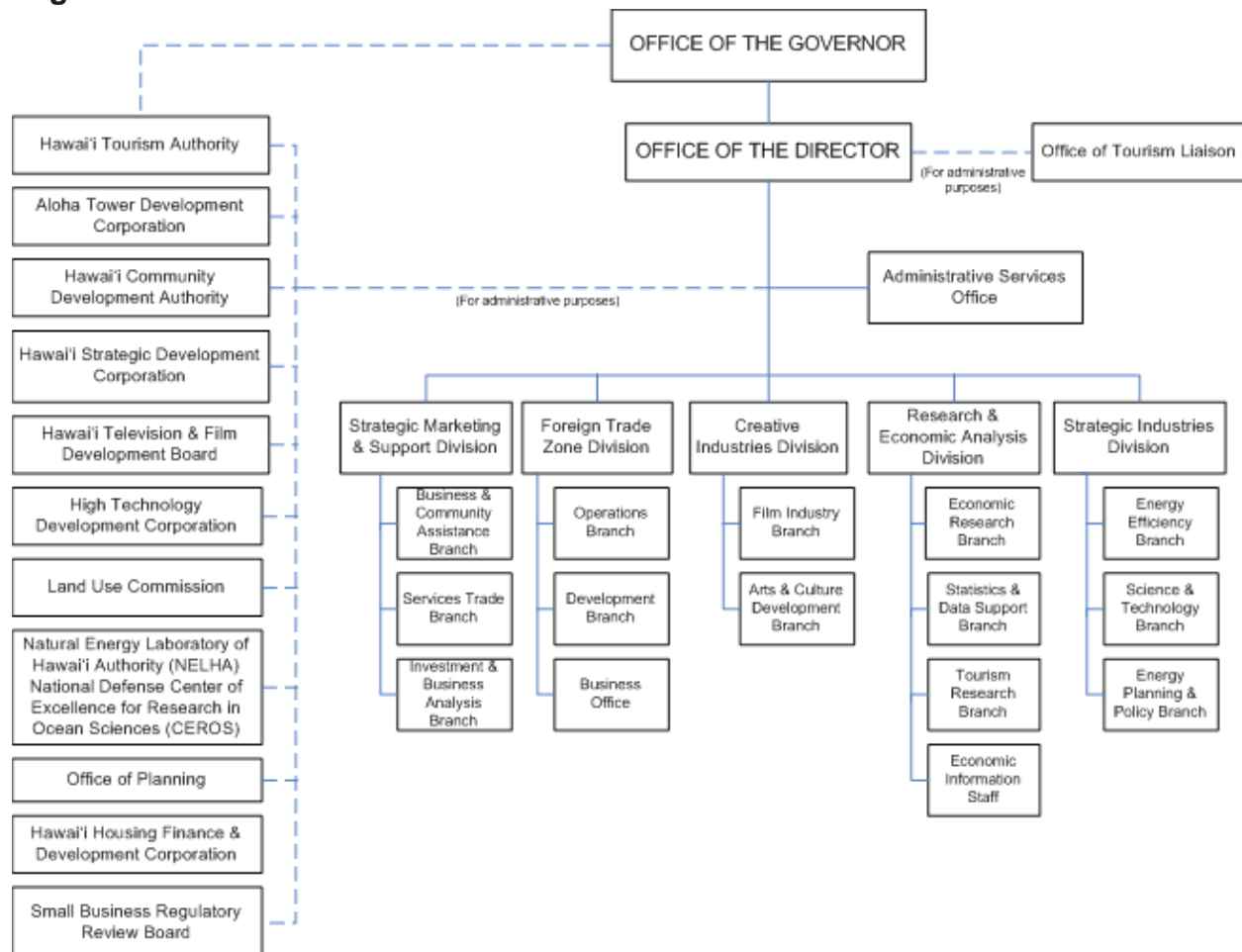
Source: Aloha Tower Development Corporation

In June 2009, the Legislature appropriated operating funds for the corporation for FY2010 but nothing for the second year of the biennium, FY2011.

Department of Business, Economic Development & Tourism

The Aloha Tower Development Corporation is administratively attached to the Department of Business, Economic Development & Tourism (DBEDT), formerly known as the Department of Planning and Economic Development (DPED). According to Section 26-18, HRS, DBEDT is responsible for statewide business and economic development activities, energy development and management, economic research and analysis, planning the use of Hawai'i's ocean resources, and encouraging the development and promotion of Hawai'i's industry and international commerce. DBEDT's various divisions and attached agencies are shown in Exhibit 1.4.

Exhibit 1.4
Organization Chart of DBEDT



Source: Department of Business, Economic Development & Tourism

Note: For FY2009-2010, NELHA was reassigned from DBEDT to the Department of Accounting and General Services (DAGS) for budget purposes. This chart shows NELHA as administratively attached to DBEDT as it is still the official organization chart of DBEDT and was obtained from the department.

Department of Transportation-Harbors Division

Because the Aloha Tower Project Area is located on the Honolulu waterfront, the Aloha Tower Development Corporation interacts extensively with DOT-Harbors. Among other powers and duties, DOT controls and manages the State's commercial harbors and waterfront improvements.

***Aloha Tower
Development
Corporation's land
development efforts***

The ATDC has a long history of attempts to develop the Aloha Tower Project Area. Some projects were focused on specific piers, while others envisioned a master development of the entire project area. Yet after almost 30 years, the corporation has completed only one development project: the Aloha Tower Marketplace.

Early efforts to develop the Honolulu waterfront

In 1978, Governor George Ariyoshi announced plans to revitalize the Honolulu waterfront in phases. The project included a major redevelopment of the Aloha Tower complex from Piers 8 to 11 and a new world trade center building for international trade functions. However, the plan was heavily criticized in our 1979 report as being financially flawed. (Our reports are described in more detail later in this chapter.) It was not until 1981 that the Aloha Tower Development Corporation was established to oversee redevelopment of the Aloha Tower complex.

The corporation selected developers for the Aloha Tower area in 1983 and 1986: Southern Pacific Development Company and Honolulu Waterfront Limited Partnership, respectively. Southern Pacific withdrew in 1984, and Honolulu Waterfront's involvement ended in litigation with the corporation, resulting in a settlement where both sides released all claims for damages. Our 1987 report called the redevelopment project unworkable and recommended it be shelved.

Development of Aloha Tower Marketplace at Piers 8 and 9 - Phase 1

In 1989, the corporation selected Aloha Tower Associates to develop the Aloha Tower Project Area, including a retail marketplace, two condo towers, an office tower, a hotel, a cruise terminal, and 2,000 underground parking stalls. The total agreed cost of the project was \$544 million. By 1992, however, Aloha Tower Associates was having financial difficulties and sought to amend its development agreement to build the project in phases. In 1994, the Aloha Tower Marketplace at Piers 8 and 9 was completed and opened for business.

Marketplace owners raised dispute over lack of parking

Thereafter, Aloha Tower Associates continued to experience financial difficulty, defaulted on payments under its lease and other agreements, and was unable to develop subsequent phases. By 1998, the developer was in bankruptcy and sold its leasehold interests in the property to Aloha Tower Limited Partnership. In 2002, Aloha Tower LP and its lender filed a suit claiming the corporation did not fulfill its commitments to approve construction of needed parking facilities and to stimulate, promote, and support the marketplace.

Lack of parking has been a longstanding issue between marketplace owners and the corporation. According to its complaint, Aloha Tower LP asked the corporation to approve plans for a parking garage on Irwin Memorial Park. The park, however, deeded by Helen Irwin Fagan in 1930 to the Territory of Hawai‘i in trust as a public park, could not be developed. Efforts by the corporation in 2001 to petition the state Land Court to remove restrictions on the park were unsuccessful. The litigation over parking, which has since transferred from Aloha Tower LP to new marketplace owners AHI Aloha Associates, LLC, is now in mediation.

Effort to redevelop Piers 5 and 6 ended in litigation

Finally, in 2004, the Aloha Tower Development Corporation entered into a development agreement for a \$350 million project at Piers 5 and 6 with Dallas-based developer Kenneth H. Hughes, Inc. In 2006, ATDC approved Hughes’ proposal for residential units, a boutique hotel, public infrastructure, and parking, subject to agreement over key issues, including ground rent and parking. Unable to reach agreement, Hughes requested arbitration in 2007. The arbitrator issued a decision in favor of Hughes in April 2009, which was confirmed by a federal judge in September 2009. The corporation and Hughes entered into a settlement in favor of Hughes for \$1.55 million in December 2009.

Exhibit 1.5 shows a chronology of events spanning three decades of the corporation’s efforts to develop the Aloha Tower Project Area.

Prior Reports

Over the past 30 years, the Office of the Auditor has issued two reports, a study related to a world trade center and redevelopment of the Aloha Tower piers and a review and analysis related to an Aloha Tower redevelopment project. Both reports expressed serious concerns about continuing redevelopment activities in the absence of adequate planning and studies.

Special Study 79-4, Evaluation of the Proposed Hawai‘i World Trade Center

In 1979 we evaluated the administration’s plans to establish a world trade center and redevelopment of the Aloha Tower piers. Our evaluation found serious deficiencies with both the world trade center concept and the proposed redevelopment of the Aloha Tower piers. We concluded it was premature to create an independent authority to implement a deficient plan and to authorize demolition and construction under the proposed plan. More work was required to clearly identify the purpose of redeveloping Piers 8 through 11, establish priorities among competing objectives, study future maritime needs and the availability of the piers for redevelopment, and investigate the costs and benefits of alternative development strategies.

Exhibit 1.5

Timeline of Events and Efforts to Develop the Aloha Tower Project Area

Date	Event
1978	Gov. George Ariyoshi announces plans to revitalize the Honolulu waterfront, including the Aloha Tower site.
1979	Legislative Auditor's report criticizes Gov. Ariyoshi's proposal, saying the idea was not given enough study and is financially flawed.
1981	Legislature approves establishment of the Aloha Tower Development Corporation (ATDC) to oversee redevelopment of the Aloha Tower complex.
1983	ATDC selects Southern Pacific Development Co. for \$100 million Aloha Tower redevelopment project, including hotel, office and retail space, and cruise ship terminal facilities.
1984	Southern Pacific pulls out of Aloha Tower redevelopment project.
1985	ATDC enters into development negotiations with Cordish Embry & Associates of Baltimore and Island Navigation/American Hawai'i Cruises.
1986	American Hawai'i Cruises drops out of project; Cordish Embry continues on as Honolulu Waterfront LP.
1987	Legislative Auditor's report calls the redevelopment project unworkable and says it should be scrapped; recommendation calls for abolishing the ATDC.
1988	ATDC prevails in court against Honolulu Waterfront LP to terminate its letter agreement.
1989	ATDC selects Aloha Tower Associates for the Aloha Tower redevelopment project, including hotel, residential, office, retail, maritime, and over 3,000 parking stalls.
1990	ATDC approves development agreement with Aloha Tower Associates.
1992	ATDC's plan and rules for the Aloha Tower Project Area are approved.
1994	Aloha Tower Marketplace grand opening; marketplace is Phase 1 of Aloha Tower Associates' redevelopment plan.
1996	State issues default notices to Aloha Tower Associates for obligations to the State. Mitsui Trust & Bank files foreclosure against Aloha Tower Associates.
1997	AHI Aloha LP (Trinity Investment Trust LLC and Apollo Realty Advisors) buys Aloha Tower Associates' mortgage.
2002	<p>Owners of Aloha Tower Marketplace (Aloha Tower LP and AHI Aloha) sue the State of Hawai'i due to unwillingness to allow the building of additional parking.</p> <p>Owners of Aloha Tower Marketplace file for Chapter 11 bankruptcy reorganization. State Land Court rules that a parking garage cannot be built on Irwin Park for the Aloha Tower Marketplace.</p>
2004	ATDC executes development agreement with Kenneth H. Hughes, Inc. for \$350 million project. Hughes had earlier identified three fatal flaws as hurdles to development: removal of the Hawaiian Electric Company plant, poor traffic flow around Aloha Tower Marketplace, and lack of adequate parking.
2005	Aloha Tower Marketplace emerges from bankruptcy. Aloha Tower LP sells the marketplace to AHI Aloha Associates.
2006	ATDC approves Hughes' revised development plan for a residential/retail project at Piers 5 and 6.
2007	ATDC and Hughes in disagreement over parking and payment for a 65-year lease on Piers 5 and 6. Hughes files demand for arbitration due to inability to agree to open items.
2009	Arbitrator rules in favor of Hughes, awards \$1.6 million in damages. Federal judge confirms arbitration award. ATDC and Hughes enter into stipulated settlement of \$1.55 million award for Hughes and against ATDC.

Source: Office of the Auditor

Report No. 87-13, *Review and Analysis of the Aloha Tower Redevelopment Project*

In 1987 we found that, six years after the Aloha Tower Development Corporation was established, the redevelopment was at a standstill, with no formal agreement with any developer. We reported that:

1. The Aloha Tower redevelopment project is a flawed concept and should be shelved. Although the Department of Planning and Economic Development originated the concept of the Aloha Tower redevelopment project as a vehicle for accomplishing the department's economic development mission, the department has tried to implement the concept without confronting and resolving the problems of financing and maritime use pointed out in our 1979 review. The department has never studied or clarified broader redevelopment issues such as those relating to waterfront development, the primacy of maritime activities at the site, existing spatial constraints, or encumbrances on the site;
2. The plan for private commercial development is in basic conflict with the site's dedicated use for maritime purposes;
3. Financing strategies for the project have been unrealistic and unworkable because of the faulty development concept; and
4. The latest spatial configuration of the project being negotiated is likely to result in redevelopment that is undesirable.

We recommended that Chapter 206J, HRS, which established the Aloha Tower Development Corporation, be repealed. We also recommended that the Legislature consider redevelopment of the Aloha Tower complex within the context of redeveloping the entire Honolulu waterfront area from Ala Moana to Sand Island.

Objectives of the Audit

1. Evaluate the appropriateness and workability of the Aloha Tower Development Corporation's mission and organizational placement.
2. Evaluate the Aloha Tower Development Corporation's management of its development efforts and the resulting financial consequences.
3. Make recommendations as appropriate.

Scope and Methodology

Our audit focused on management practices and controls of the Aloha Tower Development Corporation from FY2005 to FY2008. We examined processes dating back to the corporation's inception in 1981, as needed, to provide perspective for interpreting more recent events. Where necessary and relevant to our audit objectives, we evaluated responsibilities and functions of other state departments and agencies as they pertained to the corporation. Audit procedures included interviews with current corporation employees, current and former board members, and other stakeholders; and examination of the corporation's plans, policies, procedures, reports, and other relevant communications and documents to assess effectiveness of the corporation's performance in accordance with pertinent laws. Site visits and observations were conducted. We examined relevant documents at other departments and agencies as needed. We also assessed management controls significant to the audit objectives. The resolution requesting this audit called for a financial, performance, and management audit of the corporation, including a study of three litigated cases. We conducted a management audit, which included review of financial and other performance measures. Our scope also includes a discussion of litigation involving the corporation and relevant financial and performance information.

We conducted this management audit from March 2009 to December 2009 according to the Office of the Auditor's *Manual of Guides* and generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Chapter 2

Flawed, Obsolete, and Mismanaged, the Aloha Tower Development Corporation Should Be Abolished

The redevelopment of downtown Honolulu’s waterfront is a dream that dates back to the early 1970s. First conceived as an international trade and conference center, a redeveloped Aloha Tower complex was to welcome the world to do business with Hawai‘i. The complex was envisioned to include a renovated Aloha Tower, a hotel, and other commercial facilities.

Thirty years later, the vision remains an illusion. In 1979 our office found no evidence that a trade center at the Aloha Tower site would stimulate international commerce. We concluded that not only was the project ill-considered, but creation of an independent authority to implement such a deficient plan was premature.

In 1987, we found the Aloha Tower Development Corporation’s development efforts were at a standstill and no further along than in 1981 when the corporation was established. As in 1979, we again found that the purpose for redeveloping the area was not clearly identified nor priorities established. We recommended the Aloha Tower redevelopment project be shelved to allow full legislative consideration of waterfront use.

More than two decades later, with redevelopment efforts stalled again, our findings strike familiar themes. Our current audit found that the original constraints to redevelopment, first identified more than 30 years ago, still remain, reflecting the corporation’s inability to address these limitations. Since our last report in 1987, the corporation has managed to complete only one phase of its original development plan—and that development, the Aloha Tower Marketplace, is struggling. Moreover, the corporation’s development efforts are nagged by litigation, thereby wasting time, reputation, and money. And, even though steps were taken in 2004 to expand ATDC’s responsibilities to include harbors modernization work, we found that reasons for this expansion were not compelling.

With no redevelopment on the horizon and amid mounting litigation expenses, the Aloha Tower Development Corporation should be abolished. Responsibility for harbors infrastructure improvements should be transferred to the Department of Transportation-Harbors Division and responsibility for the Aloha Tower Project Area shifted to the Hawai‘i Community Development Authority.

Summary of Findings

1. Burdened by a litany of lawsuits and with an underperforming marketplace as its sole accomplishment, the corporation is unlikely to succeed.
2. The corporation has not addressed longstanding constraints to development and cannot justify its continued existence through harbors work.

Burdened By Lawsuits and an Underperforming Marketplace, the Corporation Is Unlikely To Succeed

Since establishment of the Aloha Tower Development Corporation in 1981, almost every development it has undertaken has resulted in litigation. The corporation has been involved in four sets of litigation; it owes upwards of \$1.6 million in damages and settlements; and it has paid over \$725,000 in attorneys' fees and costs. Its development efforts with Honolulu Waterfront Limited Partnership in the 1980s ended in a dispute over the development agreement. Its 2001 Land Court petition to remove restrictions on Irwin Park to allow construction of a parking garage failed, leaving the corporation liable for all parties' costs. Aloha Tower Marketplace owners Aloha Tower Limited Partnership and AHI Aloha Limited Partnership sued the corporation in 2002 over the State's unwillingness to allow building additional parking for the marketplace. And in 2007, Kenneth H. Hughes, Inc., which proposed redevelopment of Piers 5 and 6, filed a demand for arbitration before construction began, alleging the corporation breached its development agreement.

After 30 years of effort, little development progress has been made, and the corporation has only one underperforming project at its development site, the Aloha Tower Marketplace. Burdened by litigation costs and delays, the Aloha Tower Development Corporation is unlikely to succeed in redeveloping the Aloha Tower Project Area.

The corporation's development history is a litany of litigation

Since its inception in 1981, the Aloha Tower Development Corporation's efforts to develop the Aloha Tower Project Area have been repeatedly hampered by litigation. Developers' and the corporation's misunderstandings, miscalculations, and economic pressures, among other factors, have contributed to a history of sparse development in the project area. Legal expenses, including awards and fees, may cost the corporation over \$2.4 million. Litigation is costing the state both money and reputation.

Early development efforts resulted in costly litigation

In 1983, two years after its establishment in 1981, the Aloha Tower Development Corporation selected Southern Pacific Development Company for the Aloha Tower redevelopment project. The project was to include a hotel, office space, retail shops, cruise ship terminal facilities, and a pedestrian overpass across Nimitz Highway. A year later and before construction began, Southern Pacific pulled out of the agreement following a corporate merger, indicating that the project no longer met its new development objectives.

In 1986, the corporation signed an agreement with Honolulu Waterfront Limited Partnership for development of new maritime facilities, a hotel, office buildings, a retail complex, parking, and public improvements. By 1987, however, the corporation and Honolulu Waterfront were unable to finalize certain terms of the agreement, and the corporation filed suit, claiming it was no longer contractually bound to negotiate exclusively with Honolulu Waterfront. The lawsuit settled in 1988 with all claims being released, but left the corporation with no development progress after seven years of effort.

After a public bid process in 1989, the corporation selected Aloha Tower Associates as the developer for the Aloha Tower Project Area, stretching from Piers 5 to 14. It later approved the developer's plan, but was apprised in 1992 that the developer was having financial difficulties. The corporation and the developer reentered negotiations, resulting in an amended development agreement that allowed the project to be built in phases. The first phase included a festival marketplace at Piers 8 and 9, cruise ship terminals at Piers 10, and 11, and refurbishment of Aloha Tower. It wasn't until 1994—13 years after the corporation's establishment in 1981—that the Aloha Tower Marketplace at Piers 8 and 9 opened for business. Aloha Tower Associates continued to experience financial difficulty, defaulted on payments under its lease and other agreements, and was unable to develop subsequent phases. By 1998, Aloha Tower Associates was in bankruptcy and sold its leasehold interests in the marketplace to Aloha Tower Limited Partnership.

In 2001, the corporation attempted to solve what had become a longstanding issue between marketplace owners and the corporation: lack of parking. Efforts by the corporation in 2001 to petition the state Land Court to remove restrictions on Irwin Memorial Park to allow construction of a parking garage were unsuccessful. In 2010, the corporation was ordered to pay all parties' attorneys' fees and expenses, in the amount of approximately \$136,000.

Around the same time as the corporation's unsuccessful petition to lift restrictions on Irwin Park, Aloha Tower Limited Partnership and its lender sued the corporation in 2002, claiming the corporation had not

fulfilled its commitments to approve construction of needed parking facilities. Ordered by the court into mediation in 2003, the dispute over parking remains unresolved. Thus, as of 2003 and after what had been two decades of effort, the corporation's sole accomplishment was the completion of only one phase of what was supposed to be a multi-phased development project. Left in its wake, however, were two lawsuits, one failed petition, a first phase development with a struggling marketplace, and mounting litigation costs and attorneys' fees.

Hughes arbitration award will cost the corporation over \$1.55 million, plus over \$680,000 in attorneys' fees

In 2002, ATDC issued a Request for Proposals (RFP) for the redevelopment of Piers 5 and 6. The RFP required, among other things, that the redevelopment project's parking be sufficient to support both the proposed project uses and the Aloha Tower Marketplace. The corporation extended the RFP's due date, enabling Kenneth H. Hughes, Inc., time to respond with a Request for Qualifications (RFQ), a process which allowed Hughes to deviate from the terms of the RFP.

Hughes presented its development proposal for Piers 5 and 6, named "Pacific Quay," to the Aloha Tower Development Corporation in late 2002. The corporation subsequently entered into a predevelopment agreement in 2003 and development agreements in 2004 and 2006 with Hughes. The 2006 agreement included 300 residential units, a boutique hotel, and parking, subject to agreement over key issues, including parking. Disagreements over parking and the value of the ground lease led Hughes to request arbitration in 2007, before construction began. The Aloha Tower Development Corporation's board members said that they did not seek other development proposals for any part of the Aloha Tower Project Area after that because they decided the question of Hughes' development rights needed to be resolved.

In April 2009 an arbitrator ruled in favor of Hughes and said the manner in which the corporation negotiated, or failed to negotiate, constituted a breach of good faith and fair dealing. In December 2009, a federal judge approved a stipulated judgment and settlement of \$1.55 million for Hughes, to be paid by the corporation. The corporation reports that over \$680,000 in attorneys' fees have been incurred for legal services related to the Hughes litigation.

This costly litigation could have a large impact on the corporation's special fund, which as of November 2009 had a balance of almost \$3.1 million. At present, the corporation is seeking the 2010 Legislature's approval to raise the corporation's expenditure ceiling so that the settlement can be paid from its special fund. If approved, the Hughes settlement will cost more than 50 percent of the Aloha Tower

Development Corporation's special fund balance. This amount is equivalent to the corporation's entire annual operating budget. These moneys could have been used to advance the corporation's core mission to redevelop the Aloha Tower Project Area; instead, they may go towards paying litigation costs.

Litigation is costing the State both money and reputation

The corporation's legal expenses are considerable, totaling over \$2.4 million. The corporation was unable to provide records for the 1980s litigation involving the Honolulu Waterfront LP, so legal expenses for that case are unknown. The corporation spent \$34,000 in legal fees to petition the Land Court to lift restrictions on Irwin Memorial Park and was ordered to pay about \$136,000 to cover all parties' costs in that matter. The dispute over parking between marketplace owners and the corporation remains in mediation, but the corporation has already spent \$12,000 in legal fees. And as already mentioned, the Hughes litigation resulted in an award of \$1.55 million to be paid by the corporation. The corporation's legal costs, including settlements, awards, and legal fees, total over \$2.4 million. Exhibit 2.1 summarizes the corporation's legal costs. By way of comparison, \$2.4 million is more than double the corporation's \$1 million annual lease rent revenues from the marketplace.

In addition to the corporation's direct legal costs, there are intangible costs such as the effect of negative publicity. For example, Hughes is a developer with a national reputation and a member of the Board of Governors of the Urban Land Institute. Recent articles and editorials by local media described the Hughes arbitration with headlines such as *Tower of Trouble*, *Aloha Tower needs better development*, and *State's Aloha Tower agency should be fired*, which do not enhance the corporation's or the State's reputation. Negative publicity may be damaging and, when combined with the corporation's extensive history of litigation, may undermine the willingness of future private developers to partner with the State. The corporation's own attorneys have argued that the arbitrator's award in favor of Hughes should be vacated because it infringes on the discretionary function of state development agencies and will have a chilling effect on future development projects in the State.

After 30 years of effort, the corporation's sole accomplishment is an underperforming marketplace

An ambitious \$590 million development proposal by Aloha Tower Associates in 1989 envisioned a multi-component project for the Aloha Tower complex. Twenty years later, only the first phase was completed, leaving the Aloha Tower Marketplace to struggle without its component parts. Alone, the marketplace generated far less than was expected and was unable to realize its projected financial benefits for the State. The competed project, which was later split into phases, was projected to earn over \$4 billion over 65 years. After 30 years and with only the

Exhibit 2.1

Aloha Tower Development Corporation’s Legal Costs

Dates	Parties	Legal Issue	Resolution	ATDC’s Legal Fees	TOTAL
1987-1988	ATDC v. Honolulu Waterfront L.P.	Dispute over development agreement	Settlement to release all claims	Unknown	Unknown
2001-present	Petitioner: ATDC Respondents: William G. Irwin Charity Foundation, William L. Olds, Jr., Jane Olds Bogart Other intervening organizations	Land Court petition to remove restrictions on Irwin Memorial Park, to allow construction of a parking garage	ATDC’s petition denied. ATDC ordered to pay about \$136,000 in attorneys’ fees and costs	\$34,000	\$170,000
2002-present	Aloha Tower L.P. and AHI Aloha Limited Partnership v. ATDC, State of Hawai’i	Dispute by owners of the Aloha Tower Marketplace over alleged failure to fulfill promises	In mediation	\$12,000	\$12,000*
2007-present**	Kenneth H. Hughes, Inc. v. ATDC	Dispute over development agreement	\$1,550,000 stipulated judgment for Hughes and against the ATDC	\$681,000	\$2,231,000
		TOTAL	\$1,686,000	\$727,000	\$2,413,000***

Source: Office of the Auditor

Notes:

* The case is still in mediation, so true total cost is unknown.

** Stipulated judgment for Hughes against ATDC entered on December 7, 2009. ATDC is asking the 2010 Legislature to authorize payment of the \$1.55 million settlement from the ATDC’s special fund.

***Total costs may be higher after mediation with the Aloha Tower Marketplace owner is resolved.

marketplace to show for its development effort, the corporation has fallen far short of its core mission to redevelop the Aloha Tower Project Area.

Of the original multi-component project, only Phase 1 was completed

The ATDC issued a RFP in 1989 to select a developer who could cover substantially all the costs of developing the Aloha Tower complex and adjacent areas. The corporation would then enter into a long-term lease of up to 65 years with the selected developer. The project was to be a mixed-use development that could include retail, restaurant, office, international business center, hotel, condominium, recreation, historical, cultural elements, and sufficient parking to support the proposed uses.

Four groups submitted proposals for the project, including local developers Chris Hemmeter and Jack Myers. The corporation selected Aloha Tower Associates, a general partnership of Enterprise-Hawai'i Inc. and Aloha Tower Hawaiian Partners, in part due to the financial viability of its proposal.

The selection committee's evaluation report detailed the merits of Aloha Tower Associates' proposal, which covered an area from Piers 5 to 14. These included a total of \$4 billion to be paid to the corporation over the 65-year lease, an estimated \$56 million in public benefits to the State, and an estimated \$44 million in donations to an Enterprise Housing Fund, to be set up for the provision of affordable housing. The proposal also included an upfront \$60 million lease premium.

The completion of all components was to provide more than 3,000 parking stalls. Exhibit 2.2 from Aloha Tower Associates' 1992 promotional brochure depicts an aerial view of how the entire development might have looked upon completion.

Exhibit 2.2

Aloha Tower Associates' 1992 Proposed Development of Piers 5 to 14



Source: Aloha Tower Development Corporation

A development agreement between the corporation and Aloha Tower Associates for the entire project was executed in 1990. The entire project would cost \$544 million. In 1992, however, Aloha Tower Associates ran into financial difficulties. The corporation amended the development agreement to allow Aloha Tower Associates to develop the project in phases.

In 1994, Phase 1—the Aloha Tower Marketplace at Piers 8 and 9—opened to the public along with some related public improvements, including a refurbished Aloha Tower and cruise ship terminals at Piers 10 and 11, and a landscaped Irwin Memorial Park.

Subsequently, the financially troubled Aloha Tower Associates fell behind in payments to the state and its lender, Tokyo-based Mitsui Trust & Banking Co., Ltd., and sold the marketplace's mortgage to AHI Aloha Limited Partnership. The marketplace owners' development rights expired in 1999, with no other phases completed. Appendix A compares projected and actual public benefit outcomes at the Aloha Tower Project Area.

Lacking other development phases at the Aloha Tower Complex, the marketplace is struggling. Moreover, once Aloha Tower LP acquired bankrupt Aloha Tower Associates' lease in 1998, all of the original developer's proposed benefits evaporated. The state was not able to realize Aloha Tower Associates' projected total of \$4 billion to be paid to the corporation over the 65-year lease; an estimated \$56 million in public benefits to the State; an estimated \$44 million in donations to an Enterprise Housing Fund, to be set up for the provision of affordable housing; and an upfront \$60 million lease premium.

Aloha Tower Marketplace generated a small fraction of its lease rent projections

The Aloha Tower Marketplace fell far short of its financial expectations, resulting in a significant loss of revenue to the State. Aloha Tower Associates' 1992 proposal for Phase 1 of the Waterfront at Aloha Tower projected lease rent and additional profit participation from 1994 to 2001. Once the marketplace began operating, the lease required, among other things, that the ATDC be paid a standard annual base rent of \$1 million and an annual percentage rent based on a percentage of profits. Based on Aloha Tower Associate's 1992 proposal, we note that the marketplace was projected to generate a total of about \$22.2 million for the period 1996 to 2001. Even though the Aloha Tower Marketplace opened in 1994, it completed its first full fiscal year of operations in FY1996. During the period from FY1996 to FY2001, the marketplace paid the ATDC only about \$4.8 million. This represents only 22 percent of the forecasted revenue for those six years. The state received about

\$17 million less than was originally projected during this timeframe. The projections showed revenues would increase each year from 1996 to 2001; instead, the amount actually paid each year was the standard annual base rent of \$1 million or in some years, significantly less than that. Appendix B shows a comparison of projected to paid lease rent from 1996 to 2001. According to the corporation's CEO and based on our review of documents, the Aloha Tower Marketplace has never paid more than the minimum \$1 million in standard annual base rent.

According to the corporation's development director, the marketplace is still struggling. Underperformance is due in large part to the lack of other development in the project area and the lack of adequate parking. Without a resolution to the parking-related litigation, completed surrounding development, or subsequent development plans on the horizon, the corporation is unlikely to succeed in boosting the marketplace's poor performance.

The Corporation Has Not Addressed Development Constraints and Harbors Work Does Not Justify Its Continued Existence

The Aloha Tower Development Corporation has made little progress in 30 years of existence. Problems identified by the Auditor in 1987, including an inherent conflict between redevelopment of the project area and maritime uses, and the corporation's pursuit of unrealistic financing strategies, remain unaddressed. Moreover, with the passage of time, the events of 9/11 and their resulting harbor security and restrictions, development of the project area may no longer be viable. With little to show for its development efforts and no projects on the horizon, the corporation now justifies its existence with recently added harbor infrastructure improvement work, which has little to do with its core mission to develop the Aloha Tower Project Area. Moreover, a 2009 legislative conference committee found the corporation was unable to effectively lead the harbors modernization. The Aloha Tower Development Corporation is unlikely to succeed at redeveloping the Aloha Tower Project Area and should be repealed.

Problems identified by the Auditor in 1987 remain

We found that redevelopment of the Aloha Tower Project Area conflicts with DOT's maritime uses of the area. We also found that financing strategies pursued by the corporation with its developers have been unrealistic and unworkable. Raised in our 1987 audit over 20 years ago, these issues remain unresolved and continue to plague the corporation's efforts to redevelop the project area. Then, as now, the redevelopment project is at a standstill and the corporation lacks any formal development agreements.

Redevelopment of the Aloha Tower Project Area continues to conflict with DOT's maritime uses

Little has changed since we delivered our 1987 Report No. 87-13, *Review and Analysis of the Aloha Tower Redevelopment Project*. Then, as now, redevelopment of the Aloha Tower Project Area conflicts and may be incompatible with DOT's maritime use of the project area.

In 1987 we found the Department of Transportation controls and manages all the State's commercial harbors and waterfront improvements, including the Aloha Tower Project Area. Moreover, the DOT retains the master lease to the project area and its review and consent are required prior to any final redevelopment decisions. By statute and through agreements, the department exerts more influence over the project site than the ATDC, as no development can interfere with maritime operations at the project area, and the corporation must provide replacement facilities for maritime activities at no cost to the DOT. These conditions existed 20 years ago. Today, the corporation is no further along in resolving this inherent conflict.

While the partially developed site's use is now shared between non-maritime and maritime activities, the DOT's maritime operations continue to significantly impact the economic feasibility of the project area's development. In fact, the corporation's demonstrated preference that developers pay for the DOT's losses in revenues and replacement DOT facilities may strain developers financially.

Moreover, the board has yet to reconcile the central issue of our 1987 report relating to waterfront use. According to the 1987 report, there appeared to be a lack of understanding by the Department of Planning and Economic Development (DBEDT's predecessor agency) that redevelopment of ports is useful where maritime use is obsolete—which was, and is, not the case with the Aloha Tower site. Other successful port redevelopments, such as Boston and Baltimore, were motivated by the abandonment of active maritime use at those sites. We pointed out that the Aloha Tower site is not characterized by obsolescence or blight; rather, it is the focal point of Honolulu Harbor, the most active and important port in the state harbor system. Given this continued maritime use, an inherent conflict still exists between commercial (non-maritime) enterprise and maritime activities. And, if the corporation continues to obligate developers to finance public improvements and DOT replacement facilities, efforts to redevelop the Aloha Tower Project Area will become even more difficult.

Financing strategies are still unrealistic and unworkable

In our 1987 audit we found that financing strategies for the project were unrealistic and unworkable because of the faulty redevelopment concept.

It was unrealistic for the State to require a private developer to carry the cost of the entire project, including public and private improvements. Because public improvements—such as parks and pedestrian malls—do not generate revenue, the financial feasibility of a project becomes questionable as the demand for public improvements increases. Yet, even knowing this, the corporation persists in seeking developers who will commit to all or substantially all of the costs of development.

In 1987 we pointed out that a 100 percent developer financing structure is inappropriate and unworkable. At the time, the ATDC expected developers to finance the commercial portion of a project and meet the cost of the revenue bonds for the public improvements. The 1981 Legislature authorized \$33 million in revenue bonds to fund redevelopment of the Aloha Tower complex; that authorization lapsed, unused, in 1984. In 1985, the Legislature again authorized \$33 million in revenue bonds. In 1986, however, the administration submitted a request to the Legislature for authorization to issue revenue bonds up to \$200 million. The director of planning and economic development testified that the financial viability of the project depended to a great extent on the availability of industrial development bonds to finance the entire project. This approach adopted a developer's suggestion to finance the project 100 percent with state revenue bonds. Thereafter, by Act 129, SLH 1986, the Legislature gave the corporation the increased bond authorization to \$200 million.

Our 1987 audit questions the use of revenue bonds to fund the entire redevelopment project because: 1) under federal tax law, there are restrictions on the amount of tax exempt bonds that may be issued by a state as well as the amount which can be used for private purposes; and 2) revenue bonds could entail potential risks and liability to the State in the event of default. Responding to our 1987 report, the former DPED director (he was no longer director at the time of his response) stated that the solution was to have public funds pay for public improvements and private funds pay for private improvements. His response appears to negate his prior testimony that the financial viability of the project depended on the availability of state revenue bonds. The proposal of public funds for public improvements and private funds for private improvements never advanced, however, and in 1988 the corporation's \$200 million revenue bond authorization also lapsed, unused.

Then in 1988, what started as a bill to abolish the Aloha Tower Development Corporation ended up empowering the corporation to consider when evaluating their proposals whether potential developers were willing to finance all costs of development in exchange for nominal

rentals. This statutory power was interpreted by the corporation in one of 16 development objectives contained in its administrative rules as:

Encourage, to the extent possible, development of the Aloha Tower complex and adjoining areas by a qualified private sector developer who will provide all or substantially all of the costs of development.

Since 1989, the corporation has sought developers willing to provide all, or substantially all, of the costs of development of the Aloha Tower complex. For example, in 1990 the corporation entered into a development agreement with Aloha Tower Associates, a developer that committed to providing all the costs of development. After completing the first phase of a proposed multi-phase project, however, Aloha Tower Associates experienced financial difficulties and was unable to complete further phases.

Today, more than 20 years since our 1987 report addressed the corporation's financing strategy, the corporation's rules still contain a development objective encouraging the developer to bear all or most of the costs. Unless the corporation reassesses its financing approach and considers other financing alternatives—such as the former DPED director's idea to use public funds to develop public improvements—or offers nominal rentals in exchange for private financing as allowed in the law, redevelopment of the project area will continue to stall. Even the corporation has recognized that financial viability has been a challenge and that it must continue to look for other development options to bring about necessary redevelopment.

Redevelopment may not be as feasible as once envisioned

Consultants in 2001 and 2009 recommended limited commercial use of the Aloha Tower Project Area. Moreover, post-9/11 security requirements further restrict development. With an obsolete master plan and without an approved strategic plan, the corporation may be unaware of and unable to overcome development constraints. In the end, development of certain commercial, residential, and hotel uses at the Aloha Tower Project Area may no longer be viable.

In 2001 and 2009, consultants recommended limited commercial use of the Aloha Tower Project Area

In 2000, the ATDC's board recognized that its master plan was already ten years old and probably based on information that was 15 years old. Subsequently the board selected Group 70 International to conduct a planning and feasibility study, to include changes to the master plan. Critically important to successful redevelopment, a master plan is a document that describes an overall development concept in narrative and with maps.

In May 2001, Group 70 issued its report, *Guidance for Future Development, Piers 5-14 Area*, which noted that the Aloha Tower Marketplace and the beautification of the Aloha Tower were the only significant projects implemented under the 1991 plan. Detailing constraints to development, the report noted “[t]he absence of further development in the area since the Marketplace was completed is probably a fair indication that the uses planned in 1991 may no longer be viable.” It also observed that “[c]urrent and anticipated market conditions, physical conditions/site availability constraints with respect to provision of adequate parking, and community/maritime concerns all appear to impede the implementation of the existing plan.” The consultant’s report concluded that without changes to existing regulations limiting development to these designated uses, there would be little likelihood of any major new redevelopment occurring in the foreseeable future.

In its assessment of market conditions and issues regarding the Aloha Tower Project Area, the report found that market support for the most obvious uses (office, retail and entertainment, hotel, and residential) of Piers 5-14 was not evident. Office use would not be suitable because the project would require financially strong anchor tenants willing to lease enough space at a high enough rent to reduce the marketing risk in order to make such a development financially viable. Such deals require subsidies, incentives and/or landlords’ potential participation in tenants’ business success to make them work; the necessary combination of these requirements did not appear to be likely to occur in the foreseeable future.

Additional retail use would also be difficult because the marketplace is considered a secondary location due to its weak merchant mix; and its lack of convenient, free parking contributes to the difficulty in attracting stronger tenants. The report noted that retail uses at the marketplace had met with mixed success. Theme and water parks featuring the waterfront location were potential entertainment uses, but the land comprising Piers 5-14 is probably not large enough for such uses.

Similarly, the small footprint of Piers 10 and 11 limits the size of a potential hotel. And even if a hotel were built, the attractiveness of the Aloha Tower Project Area’s location is questionable, as it does not offer the activities of Waikiki, only three miles away. Moreover, in 2001, hotel revenue simply did not support the cost of new construction. Residential use would hinge upon the State’s ability or willingness to sell its fee simple interest in the land covering the Piers 5-14 Area. Development of condominium units would likely require the state to sell its interests in the land; nor are rental apartments financially feasible unless the state or some other public entity subsidized the development.

Finally, the consultant's report urged the corporation to solve the parking, vehicular, and pedestrian access and circulation problems as one of its top priorities. It also recommended amending the ATDC's development plan and rules to allow greater flexibility of potential uses and invite creative development proposals for the areas that entrepreneurs determine are most viable. In our review of corporation minutes immediately following the release of the Group 70 report, however, the board failed to take action to amend its development plan and rules. In effect, the corporation paid the consultant \$130,000 for a review and subsequently disregarded its responsibility to update the master plan or advance development efforts at the Aloha Tower Project Area, wasting both time and money.

Five years later, in 2006, the corporation requested that the governor approve the hiring of another planning consultant to update the rules, stating that the corporation "cannot move forward with new development proposals without an update of the [Hawai'i Administrative Rules]." Upon the governor's approval, the corporation hired R.M. Towill in 2007 for \$150,000. Despite the rationale that the corporation could not move forward without updated rules, however, the corporation did not extend the contract, and Towill was not allowed to complete its work. On February 25, 2009, the corporation's CEO reported to the board that Towill's contract had expired and was not extended. Two days later Towill issued a *Preliminary Summary Report Prepared in Partial Fulfillment of the Aloha Tower Master Plan Update*. In summary, Towill preliminarily recommended that development of Piers 5 and 6 include structured parking, more park land and moorings for ships, development of commercial/retail space over the water between Piers 6 and 7 and Piers 8 and 9, and a Fort Street overpass park stretching across Nimitz Highway. The preliminary recommendations did not include hotel or residential uses, but did say the parking structure could be developed to provide a platform for additional office or retail space.

The corporation did not provide a uniform explanation for its decision not to extend Towill's contract or enable the consultant to provide a final and more fully-developed report. The former corporation board chair first told us that the corporation was "not fully satisfied" and, in her opinion, may need to contract with another consultant. However, a report signed by the CEO reflects a completely different view. The report states the corporation was indeed satisfied with Towill's performance. However, during the April 2009 board meeting, the former chair said that she and a member of the board's New Opportunities Committee wanted to do some additional work outside of Towill's initial results, so they let the contract lapse. The corporation's development director told the Public Advisory Group in May 2009 that Towill's contract was not extended due to the corporation's unknown status during the legislative session. At that time, two bills were under consideration that would have impacted the agency's ability to function. One proposal calling for the

abolition of the ATDC failed. However, the other measure was approved and left the agency with budget for FY2010, but no funding for FY2011. And finally at the June 2009 board meeting, the former chair said Towill was charged with providing suggestions on specific development projects. She said that partially as a result of some of the questions from this audit, a broader perspective was being sought. These differing—and in some cases, conflicting—reasons given by the corporation and its board display a lack of consensus and coherence regarding its ability to effectively address an issue it deemed so vital that it could not move forward with new development. Even though it had approval to pay Towill to finish the work, it chose instead not to extend the contract and paid only \$58,000 in partial fulfillment of the contract.

The corporation has known since 1999 that its master plan and administrative rules are outdated and that this has affected its ability to accomplish its mission. Yet, even with two opportunities and professional advice from credible consultants, it has shirked its responsibility to complete this vitally important task. In its folly, the corporation has wasted both time—ten years—and money—a total of about \$188,000 (\$130,000 and \$58,000 to Group 70 and Towill, respectively) and still does not have an updated master plan or rules. The corporation should not be afforded a third opportunity to hire yet another consultant to complete these tasks.

Post-9/11 security requirements further restrict development

The terrorist events of September 11, 2001 render commercial, residential, and hotel uses at the project area even less viable. One of the federal government's responses to the 9/11 attacks was the Maritime Transportation Security Act of 2002, which is a broad range of programs for the security of vessels, ports, and waterways. Because the Aloha Tower Project Area is located on the waterfront, maritime restrictions will likely further limit the economic feasibility of development alternatives by making it difficult, if not impossible, to build hotel, office or residential structures on the waterfront, particularly where there are cruise ship terminals. In fact, restrictions have already impacted parking.

Maritime security protocols have had a detrimental effect on parking, exacerbating the existing parking shortage. Since 9/11, access in and around docks can be restricted by the U.S. Coast Guard. Parking stalls at Piers 10 and 11 already have restrictions on their use: for instance, on weekends when a cruise ship is docked, as many as 78 parking spaces are unavailable for Aloha Tower Marketplace customers.

We asked the DOT-Harbors administrator about these restrictions. He explained that current maritime security rules may have several effects on the Aloha Tower Project Area. First, additional screening of

passengers and vehicles entering parking near cruise and charter vessels at Piers 5-8 will be required. Second, building a hotel at Piers 10 and 11 near the cruise boat passenger facility would be considered a drastic change and require a rewrite of the Facility Security Plan. There is a security concern regarding development of Piers 10 and 11 because of the potential risk that any person or vehicle entering or residing in a building adjacent to the passenger facility can pose to a cruise ship with thousands of guests and crew members on board.

Given this, it is unlikely that Aloha Tower Project Area development can proceed under any plan and rules that predate the events of 9/11. And because the corporation's plans and rules date to the 1990s, the corporation does not know whether development will be more difficult or even virtually impossible given the changes that have occurred post-9/11.

The corporation lacks a strategy to carry out a master plan

Even if its master plan were not obsolete, the corporation would not be able to execute it. We asked both the chief executive officer and the former board chair about the corporation's strategic plan. The chief executive officer said that the corporation's Yearly Activity Plans—a requirement of the Department of Business, Economic Development & Tourism—serve as its strategic plan. The former board chair stated that the board uses the corporation's mission statement and the 16 development objectives in its administrative rules as a long-term strategic plan.

Strategic planning is a process in which an organization takes a fresh look at its mission and how to best meet that mission, according to *Making Results-Based State Government Work* by The Urban Institute. Strategic planning also involves considering alternative ways to carry out a mission and its likely costs, outcomes, and feasibility. It is usually intended to encourage innovative thinking as to how best to meet a need. Strategic plans should also cover a number of years beyond the budget period—three years at a minimum—and include appropriate analyses of background information, alternatives, costs and benefits, and roles for various institutions or agencies involved in implementation.

We found that neither the Yearly Activity Plans nor the 16 development objectives meet the requirements of a strategic plan. Many of the indicators in the corporation's yearly plans lack specific measurable outcomes. For example, one indicator says, "Increase in revenue from the Aloha Tower Project Area," but provides neither an amount nor a timeframe for the increase. Another says, "Improvement in the commercial success of the Aloha Tower Marketplace." However, there are no benchmarks to determine whether the ATDC is making any progress toward achieving its goal of commercial success at the marketplace. Thus, we find the Aloha Tower Development Corporation's

yearly activity plan is not a strategic plan. Moreover, the 16 development objectives represent broad guidance rather than a strategic plan. The development objectives do not provide an analysis of costs and benefits of ways to achieve the corporation's objectives.

As a result of our inquiry, at an April 2009 board meeting, the former chair raised the idea of initiating a board strategic planning session, and the corporation published its draft strategic plan in November 2009. Until a plan is approved that meets the requirements of a strategic plan, the Aloha Tower Development Corporation would be unable to carry out any updated master plan.

***Recently added
harbors work
does not justify
the corporation's
continued existence***

Beginning in 2004, steps were taken to expand ATDC's responsibilities and involve the agency in a harbors modernization plan that extended beyond the Aloha Tower Project Area. The administration advanced two reasons in support of the corporation's involvement: first, the harbors modernization effort needed the corporation's development expertise; second, the effort also needed the corporation's ability to enter into public-private partnerships to provide additional sources of funding. We found neither of these reasons compelling. The corporation's unsuccessful development efforts at the Aloha Tower Project Area do not qualify as development expertise, and DOT-Harbors' approach to funding harbor infrastructure improvements does not contemplate private financing, thus negating any need to enter into public-private partnerships. Furthermore, any amended authority allowing the redirection of corporation revenue (as contemplated by the corporation to fund its litigation obligations) could starve efforts to develop the Aloha Tower Project Area.

Reasons for involving the corporation in harbors work are not compelling

Since its establishment almost 30 years ago, the corporation has demonstrated limited expertise in the development of state property. It has developed only the first phase of a multi-phase, master planned project; and this first phase, the Aloha Tower Marketplace, is struggling. In addition, almost all of the corporation's development efforts have resulted in litigation and significant cost to the State.

According to the corporation's CEO, it was the administration who requested she work at the ATDC because the agency was engaged in a major initiative to work on infrastructure for Honolulu Harbor. She added that the focus on harbors modernization came about because in 2004-2005, the state harbors were facing a crunch for maritime space. She said a member of the administration contacted her about moving to the ATDC when she was employed at the Hawai'i Community

Development Authority. According to the minutes from the August 3, 2004 board meeting, the director of DBEDT said the personnel move would enable several initiatives to move forward, including harbors work, where the ATDC can play a very active role. The corporation's CEO agreed to the move and started at the ATDC in September 2004 as the director of waterfront development. This personnel move marked the beginning of the buildup towards an administration initiative to improve harbors statewide.

In 2005, the administration assigned the corporation to lead a harbors task force and later submitted an administration bill requesting legislation to allow the Aloha Tower Development Corporation to work as "the State's development arm." The administration advanced two reasons why DOT was hampered in doing harbors redevelopment: 1) that harbors was focused on management, rather than development; and 2) lack of development-oriented options, such as public/private partnerships. We find neither of these reasons compelling. In 2007, the Legislature passed a bill that established a formal partnership between the corporation and the Department of Transportation-Harbors Division for the development of Honolulu Harbor infrastructure. Lawmakers believed the partnership was necessary because: 1) the corporation offers development expertise; and 2) its ability to enter into public-private partnerships would help address funding issues for the Harbors Division.

First, the corporation's development expertise is limited, at best. As we have pointed out, the corporation has developed only the first phase of a master planned project and this development, the Aloha Tower Marketplace, is struggling. Even the director of business, economic development & tourism, who is a corporation board member, could not provide an example of the corporation's development expertise. Instead, he offered, "Whether or not you agree with the success of the Aloha Tower Marketplace, the ATDC has more experience [than DOT-Harbors]. Even failed experience is valid." We disagree with the director's statement. Although failed experience may translate into lessons learned, we disagree that it qualifies as valid experience, especially when development failures outweigh development successes. Moreover, the corporation has no expertise in harbors modernization and to suggest that it is suited to carry out such plans statewide is illogical and misguided, especially when its core mission since inception has been to develop the Aloha Tower complex in Honolulu Harbor.

Further, the expectation that the corporation could provide DOT with development expertise for the Harbors Modernization Plan hinges somewhat on the corporation's ability to expeditiously fill 18 positions that have been approved for harbors work. As of July 2009, only four of those positions have been filled. Some of the delay is purposeful on the part of the corporation because legislation that would have eliminated

the agency was considered in the 2009 session. The corporation's chief executive officer stated at a recent board meeting that it would be unfair for more employees to come to the corporation with its future status unknown. Yet, the fact remains that as of 2009, the corporation has only a small portion of the expected personnel to carry out the Harbors Modernization Plan. The statute that establishes the partnership for harbors work will expire in 2016. This leaves the corporation little time to hire staff, and to implement statewide harbor infrastructure improvements prior to the sunset date.

Second, the corporation's ability to enter into public-private partnerships to provide additional sources of funding is not needed. This approach is inconsistent with DOT-Harbors' approach to harbors modernization. We inquired about harbor project funding; DOT-Harbors confirmed that all Harbors Modernization Plan projects are publicly funded via funds from the Harbors Special Fund or Harbors' revenue bonds. And given its poor record regarding the redevelopment of the Aloha Tower area, it is not clear whether the expertise of the corporation provides a benefit in the effort of modernizing Hawai'i's harbors. Thus, despite the urgent need to carry out the harbors work, the Aloha Tower Development Corporation has little expertise to offer DOT-Harbors and has not met the administration's justifications for its involvement. We disagree with the assertion by the director of business, economic development & tourism that eliminating the Aloha Tower Development Corporation would "seriously hamper adequate oversight of those[harbor redevelopment] projects." On the contrary, we conclude that the corporation should not be involved in implementing harbor improvements.

Redirection of corporation revenue to harbors work may starve efforts to redevelop the Aloha Tower Project Area

The corporation's primary source of revenue is lease rent from the Aloha Tower Marketplace. Over the years, it has collected no more than \$1 million base rent per year from the marketplace. The corporation's revenues and expenses flow through the Aloha Tower Fund for the redevelopment of the Honolulu waterfront. In 2006, however, the administration sought revenue for its harbors initiative and identified the Aloha Tower Fund as a potential source of funding. In their November 2006 *Hawai'i Harbors Task Force* report to the Legislature, the three agencies belonging to the Harbors Modernization Group—the corporation and the departments of Business, Economic Development & Tourism and of Transportation—recommended creating the authorization to direct the corporation's net revenues to a fund for

harbors development. In 2007, the corporation's statute was amended to allow the redirection of revenues. Section 206J-5.5(g), HRS, provides:

Subject to existing contractual and statutory commitments to the department of transportation for any losses in revenue under this chapter, the development corporation may apply any revenues derived from commercial development projects in the Aloha Tower project area to defray the cost of harbor infrastructure improvements incurred within the State. (emphasis added)

Under the statute, the corporation would first pay any debt to the DOT for lost revenues at the Aloha Tower Project Area before applying moneys to statewide harbors improvements. The intent to fund harbors is detailed in the preambles for both Act 127, SLH 2007, and Act 200, SLH 2008:

A partnership with the Aloha Tower development corporation, which has jurisdiction over a portion of Honolulu harbor, can also assist the harbors division by providing financial support from its limited commercial development along the downtown urban waterfront. Revenues generated from commercial development are proposed to be directed towards the funding of commercial harbor system infrastructure improvements.

This ability to redirect funds will not help the corporation achieve its core purpose and could potentially starve redevelopment of the Aloha Tower Project Area. In fact, the potential effect of this statutory provision is evident in a 2007 email received by the corporation's chief executive officer, the deputy director of harbors, the director of business, economic development & tourism, and the director of finance over use of the Aloha Tower Fund to improve harbor infrastructure:

Email from deputy director of business, economic development & tourism to the corporation's chief executive officer:

“ . . . identify amount and pledge revenue streams from ATDC and ATDC controlled lands to bonds to support system-wide improvements.”

Email from deputy director of business, economic development & tourism to his director, the deputy director of harbors, and the director of finance:

“ATDC pledges all revenue past operational requirements to the improvement effort. Cash flow is \$250,000 a year.

Also the possibility of a \$50 [million] infusion from the development of the Ken Hughes project.”

Although the Hughes development never came to fruition, these emails show that as early as July 2007 the administration was already planning to redirect funds from the Aloha Tower Fund to defray the cost of statewide harbor infrastructure improvements. If the Hughes deal had been completed at the State’s valuation, as much as \$50 million would have been available to apply towards harbor improvements statewide. We question whether redirection of the corporation’s mission and funds to harbor modernization comports with the corporation’s mission of redeveloping the Aloha Tower complex.

The corporation should be repealed on June 30, 2011 to allow for orderly transitions

During the 2009 legislative session, the conference committee on House Bill 200, which became the General Appropriations Act of 2009, Act 162 (SLH 2009), expressed doubts about the corporation’s management abilities and moved to restore the harbors modernization responsibilities to the Department of Transportation:

The Aloha Tower Development Corporation remains entangled in litigation and has not completed any projects related to the Harbors modernization plan. Your Committee on Conference finds that the Aloha Tower Development Corporation is unable to effectively lead the Harbors Modernization Plan and carry out the functions for which it was created; consequently, your Committee restored the responsibility of improving harbors to the Department of Transportation, Harbors Division in fiscal year 2011.

The Legislature also appropriated only one year of operating funds for the Aloha Tower Development Corporation.

We concur with the conference committee that the ATDC is unable to effectively lead the Harbors Modernization Plan. We also recommend that responsibility for harbor improvements be restored to DOT-Harbors on June 30, 2011, to allow for an orderly transition. Further, the Hawai‘i Community Development Authority should have jurisdiction over the Aloha Tower Project Area. This transfer of responsibility also entails transfer of the corporation’s rights and obligations, including the ground lease to the project area with DOT and the lease with the Aloha Tower Marketplace, and the corporation’s debt to DOT-Harbors.

Responsibility for harbor improvements should be restored to DOT-Harbors

As expressed in its conference committee report on the General Appropriations Act of 2009, the Legislature's confidence in the corporation's ability has eroded. It did not view the corporation as the most capable body to lead the effort to modernize the State's harbors. Instead, the Legislature restored this responsibility to DOT-Harbors. As the agency with statutory responsibility to establish, maintain, and operate transportation facilities of the State, including highways, airports, and harbors, the department also has the statutory responsibility to plan for the State's transportation needs through its functional plan.

All commercial harbors, roadsteads (a place less enclosed than a harbor where vessels may ride at anchor), and commercial waterfront improvements controlled by the State are under the control of DOT-Harbors, as well as all vessels and shipping within the commercial harbors and roadsteads. All moneys appropriated for commercial harbor improvements, including new construction, reconstruction, repairs, salaries, and operating expenses are spent from the Harbor Special Fund. Thus, because DOT-Harbors already has responsibility for Hawai'i's harbors and controls the resources for harbor improvements, it should be the lead agency to carry out the Harbors Modernization Plan.

DOT-Harbors has also expressed interest in absorbing this function. During the 2009 session, when a conference committee suggested that DOT-Harbors take on the harbors modernization function, the deputy director for harbors stated that the DOT wants the ATDC to be attached to the DOT. The department suggested that it might take that position during the 2010 legislative session.

To allow for an orderly transition, DOT-Harbors should work with the Aloha Tower Development Corporation to effectuate an orderly transfer of rights, powers, functions, and duties for statewide harbor improvements by June 30, 2011. Because the DOT already controls planning and funding of the Harbors Modernization Plan, harbors functions can be transferred without retaining the Harbors Modernization Group, which currently includes the members of the Aloha Tower Development Corporation board.

The Hawai'i Community Development Authority should have jurisdiction over the Aloha Tower Project Area

More than 30 years ago, we identified the Hawai'i Community Development Authority as an appropriate agency for waterfront planning and development. In our 1979 Report No. 79-4, *Evaluation of the Proposed Hawai'i World Trade Center*, we found that HCDA's expertise "perhaps comes closest to that needed to plan for the Aloha Tower

piers.” This was two years prior to the establishment of the Aloha Tower Development Corporation.

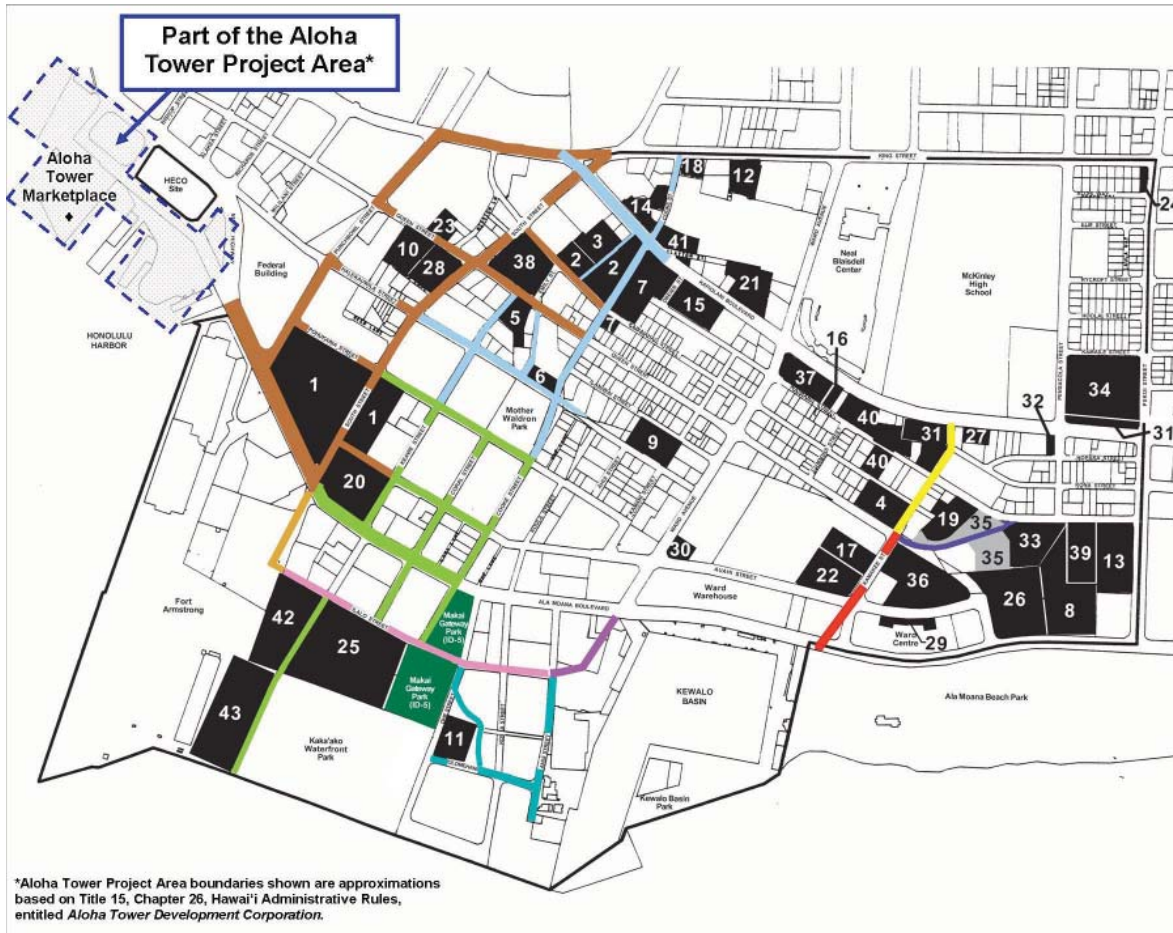
The authority was established by the Legislature in 1976 as a body corporate and a public instrumentality of the State for the purpose of joining strengths of private enterprise, public development, and regulation into a new form capable of long-range planning and implementing improved community development. Like the corporation, the authority is attached to DBEDT for administrative purposes.

Hawai‘i Community Development Authority’s jurisdiction already includes development in waterfront areas. Act 355, SLH 1987, enabled the authority to assume responsibility for planning and regulating development activities in the waterfront area from Kewalo Basin to Fort Armstrong. The Legislature found that the waterfront had great potential to serve the State’s economic, maritime, and recreational needs and that “planning for the waterfront area could be more effective and cost-efficient if one body had jurisdiction over that area.” Currently, the authority’s Kaka‘ako Community Development District includes the area bounded by Pi‘ikoi, King, and Punchbowl streets and Ala Moana Boulevard, as well as the stretch of waterfront from Kewalo Basin to Forrest Avenue. It also includes the Hawaiian Electric Company power plant site, next to the corporation’s project area. Even the 2009 Legislature’s Senate Ways and Means Committee expressed that extending the HCDA’s authority over the Aloha Tower Project complex would provide for consistency with planning and development, which would be advantageous to the State.

Although the authority may be the best fit for the corporation’s development responsibilities, the authority’s redevelopment efforts have not been without controversy. Community opposition to a residential development planned for Kaka‘ako Makai led to 2006 legislation prohibiting the authority from approving any residential development in the makai area of its Kaka‘ako Community Development District. However, the visions of the authority and the corporation are comparable—beautification of the waterfront, public access, and the creation of a “people place.” While the Aloha Tower complex area is considered “valuable” property, the authority’s area is classified as “blighted and underdeveloped.” The corporation is charged with addressing maritime needs in the Aloha Tower complex area while the Hawai‘i Community Development Authority’s main focus is on community development needs.

As of 2007, the authority had successfully completed 34 projects in Kaka‘ako. Exhibit 2.3 illustrates the authority’s completed projects as of April 2007. The boundaries of a portion of the Aloha Tower Project Area site have been added in order to compare the corporation’s and authority’s jurisdictions.

Exhibit 2.3
2007 Map of HCDA's Development Projects



*Aloha Tower Project Area boundaries shown are approximations based on Title 15, Chapter 26, Hawai'i Administrative Rules, entitled *Aloha Tower Development Corporation*.

Hawaii Community Development Authority
DEVELOPMENT PROJECTS IN KAKA'AKO

Current and Future Projects

- 35. Queen Street Extension Park
- 36. Ward Village Shops
- 37. 909 Kapiolani
- 38. Keola La'1
- 39. Nauru Phase 4
- 40. Moana Vista
- 41. 720 Kapiolani Blvd. Project (NCR Bldg. Renovation)

In Negotiations

- 42. Cancer Research Center of Hawaii
- 43. OHA Headquarters/Hawaiian Cultural Center Project

INFRASTRUCTURE IMPROVEMENT PROJECTS

- Improvement District 1 (1988)
- Improvement District 2 (1990)
- Improvement District 3 (1993)
- Improvement District 4 (1999)
- Improvement District 5 (Gateway Park) (1998)
- Improvement District 6 (2000)
- Improvement District 7 (2002)
- Improvement District 8 (2003)
- Improvement District 9 (2003)
- Improvement District 10 (2004)
- Improvement District 12 (2007)

Completed Projects

- 1. One Waterfront Plaza & Towers
- 2. Pacific Park Plaza
- 3. Royal Capitol Plaza
- 4. Kamakee Vista (Affordable Rentals)
- 5. Pohulani (Affordable Elderly Rental)
- 6. Na Lei Hulu Kupuna (Affordable Elderly Rental)
- 7. The Imperial Plaza
- 8. Nauru Tower
- 9. Kauhale Kaka'ako (Affordable Rentals)
- 10. Honuakaha (Affordable Elderly Rentals/Affordable Condos)
- 11. Children's Discovery Center
- 12. One Archer Lane
- 13. Hawaiki Tower
- 14. Servco/Lexus Showroom
- 15. BMW on Kapiolani
- 16. Altres Building
- 17. Nordstrom Rack
- 18. Tesoro Gas Express
- 19. 1133 Waimanu (Affordable Condos)
- 20. CompUSA
- 21. Theo Davies
- 22. Ward Entertainment Center
- 23. Word of Life Sanctuary
- 24. Sub-Zero Showroom
- 25. UH John A. Burns School of Medicine
- 26. Hokua
- 27. Kapiolani Express
- 28. Honolulu Fire Dept. Headquarters/Museum
- 29. Ward Centre Auahi Street Shops
- 30. Ward Gateway Retail Shops
- 31. Public Storage
- 32. Wedding Ring Shop
- 33. Ko'olani (Nauru Phase 3)
- 34. Moana Pacific

Map Prepared: April 2007

Sources: Hawai'i Community Development Corporation. *Aloha Tower Project Area highlights by the Office of the Auditor.

Private investment in Kaka‘ako totaled \$304 million in 2008. The authority’s 2008 annual report shows it has also completed three major infrastructure projects over the past four years to prepare Kaka‘ako’s waterfront lands for development.

Organizationally, the two agencies are very similar. They share comparable board and authority structures, with the directors of transportation and of business, economic development & tourism serving on both agencies’ boards. In addition, the executive director of the authority, whose duties are similar to those of the corporation’s chief executive officer, would assume the responsibilities of that official, thereby rendering the corporation’s position unnecessary. In some instances, the authority’s statutory powers exceed those of the corporation’s, making the transfer a viable and attractive alternative with development benefits. For example, the authority can assess community districts for the costs of improvements and has the power of property condemnation. Consolidation of the Aloha Tower Project Area under the authority’s jurisdiction would streamline government by eliminating the corporation’s board, expenses, and administrative support.

The current administration has also recognized duplication between the two agencies. In 2003 the governor proposed merging the authority and the corporation. When asked about recurring proposals to merge the two agencies, the director of business, economic development & tourism told us he had advanced such a proposal and, if the corporation is viewed strictly as a redevelopment agency, it is reasonable for that function to be consolidated under one agency.

In a transfer of the corporation’s redevelopment responsibilities, the authority would need to assume responsibility for the corporation’s contractual rights and obligations, including the corporation’s ground lease with the DOT, which covers Piers 5 to 14, and the lease with the Aloha Tower Marketplace. The authority would also need to discuss the almost \$7.7 million the corporation owes the DOT for lost revenues and, if no alternate arrangement is made, assume this debt, which would be paid over time from lease revenues generated by the marketplace. Finally, the authority would need to step into the shoes of the corporation to resolve the corporation’s legal disputes and debts.

Upon the orderly transfer of responsibilities from the corporation to the authority, the corporation should be repealed on June 30, 2011. Suggested legislation to effectuate the sunset of the corporation is attached as Appendix C.

Conclusion

After almost 30 years, the Aloha Tower Development Corporation has been unable to achieve its mission to redevelop the Aloha Tower Project Area. The agency has failed to address constraints and restrictions to create a feasible plan to redevelop the project area. The corporation's one development attempt at the site ended with only a fraction of the work completed and a struggling retail enterprise, the Aloha Tower Marketplace. Besides the shortfall in expected revenues, litigation expenses have cost the corporation and the State time, reputation, and upwards of \$2.4 million.

The corporation board has failed in its leadership responsibility to develop and update a workable master plan and adjust for constraints to development, including new maritime security regulations following the terrorist events of 9/11. Despite having nearly three decades to plan and study, the corporation still lacks a focused strategy to achieve its mission. Given its poor planning history, the corporation is unlikely to develop the Aloha Tower Project Area and should not be given any more chances to do so. The responsibility should be transferred to the Hawai'i Community Development Authority, with its comparable functions and greater development authority.

Responsibility for statewide harbor improvements should be returned to DOT-Harbors. The Legislature has lost confidence in the corporation, believing the corporation is not able to effectively lead the Harbors Modernization Plan. Together, the litany of errors and missteps spanning three decades that make up the Aloha Tower Development Corporation's history compel our recommendation to repeal the corporation.

Recommendations

1. The Legislature should:
 - a. Repeal Chapter 206J, HRS, on June 30, 2011 to abolish the Aloha Tower Development Corporation;
 - b. Direct the Aloha Tower Development Corporation, the Hawai'i Community Development Authority, and the Department of Transportation to develop and submit a plan to the Legislature, 20 days before start of the 2011 legislative session, to provide for the orderly transfer of the rights, powers, functions, and duties of the Aloha Tower Development Corporation to the Hawai'i Community Development Authority; and

- c. Direct the Aloha Tower Development Corporation and the Department of Transportation to develop and submit a plan to the Legislature, 20 days before start of the 2011 legislative session, to provide for the orderly transfer of rights, powers, functions, and duties of the harbors modernization group to the Department of Transportation, Harbors Division.

Appendix C provides draft legislation for the above.

2. The Hawai'i Community Development Authority should:
 - a. Update the master plan and rules for the Aloha Tower Project Area and develop a strategic plan to carry out the plan, given the current constraints to development; and
 - b. Enter into discussions with the Department of Transportation, Harbors Division, to resolve the Aloha Tower Development Corporation's \$7.7 million debt to DOT-Harbors for lost revenues.

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Appendix A
Comparison of the ATDC's Projected vs. Actual Public Benefit Outcomes

Benefit	Proposed by Aloha Tower Associates in 1989 (Based on all phases built)	Actual Benefit Completed (Based on Phase 1 Aloha Tower Marketplace)
Parking	3,005 parking stalls.	731 parking stalls.
Aloha Tower	Aloha Tower refurbishment.	Completed.
Irwin Memorial Park	Irwin Park enhancement consisting of improvements and elimination of parking spaces.	Refurbishment and relandscaping completed. Parking spaces at Irwin Park not eliminated.
Cruise ship terminals	Cruise ship terminals on Piers 5, 6, 10, and 11.	Two cruise ship terminals at Piers 10 and 11 completed. Cruise ship terminals at Piers 5 and 6 not built.
Honolulu Historic Park	Honolulu Historic Park, a new facility at Pier 12.	Not built.
Water Sports Center	Duke Kahanamoku Water Sports Center.	Not built.
Fund for affordable housing	The developers would establish a housing fund administered by a non-profit foundation for the provision of affordable housing, which would be augmented with a percentage of net profits from the project. Housing fund donations estimated at \$44 million.	According to the 1993 Marketplace Lease, the developer has established a not-for-profit Housing Foundation, however, ATDC is not aware of any housing fund.
Lease premium	\$60 million cash to be paid upon execution of lease.	The \$60 million lease premium was allocated among project components, but not Phase 1. Since other components were not built, \$0 received.

Source: Office of the Auditor

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Appendix B

Comparison of Projected to Paid Lease Rent, 1996 to 2001

Fiscal Year	Projected Lease Rent (Note 1)	Paid Lease Rent (Note 2)	Difference
1996	\$1,709,000	\$833,333	\$(875,667)
1997	\$2,544,000	\$416,667	\$(2,127,333)
1998	\$3,815,000	\$666,667	\$(3,148,333)
1999	\$4,098,000	\$1,000,000	\$(3,098,000)
2000	\$4,831,000	\$916,667	\$(3,914,333)
2001	\$5,158,000	\$1,000,000	\$(4,158,000)
Total	\$22,155,000	\$4,833,334	\$(17,321,666)
	Percent paid	21.8%	

Source: Office of the Auditor

Notes:

1: Based on the Aloha Tower Associates' 1992 projections for percentage rent (subject to the standard base rent of \$1,000,000 per year) and additional lease rent-profit participation. Fiscal year 1996 represents the first full fiscal year of operations of the marketplace.

2: During this period the annual amount paid never exceeded the minimum base rent.

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A BILL FOR AN ACT

RELATING TO THE ALOHA TOWER DEVELOPMENT CORPORATION.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The purpose of this Act is to abolish the Aloha
2 Tower development corporation and to transfer all rights,
3 powers, functions, and duties to the Hawaii community
4 development authority; provided that rights, powers, functions,
5 and duties relating to harbors modernization group are to be
6 transferred to the harbors division of the department of
7 transportation.

8 SECTION 2. The Hawaii community development authority and
9 the department of transportation, with the assistance of the
10 Aloha Tower development corporation, shall develop a common plan
11 to identify the respective rights, powers, functions, and duties
12 of the Aloha Tower development corporation that shall be
13 transferred to the Hawaii community development authority and
14 the remaining rights, powers, functions, and duties of the Aloha
15 Tower development corporation relating to the harbors
16 modernization group that shall be transferred to the harbors
17 division of the department of transportation.



B. NO.

1 Furthermore, the Hawaii community development authority and
2 the department of transportation, with the assistance of the
3 Aloha Tower development corporation, shall review options and
4 determine the most viable option to effectuate a complete and
5 orderly transfer by July 1, 2011 of all rights, powers,
6 functions, and duties of the Aloha Tower development corporation
7 to the Hawaii community development authority, and the remaining
8 rights, powers, functions, and duties relating to the harbors
9 modernization group to the harbors division of the department of
10 transportation.

11 SECTION 3. Not later than twenty days prior to the
12 convening of the Regular Session of 2011, the Hawaii community
13 development authority and the department of transportation, with
14 the assistance of the Aloha Tower development corporation, shall
15 submit the common plan to the legislature, including proposed
16 legislation, that details the most viable option to effectuate a
17 complete and orderly transfer by July 1, 2011 of all the powers
18 and duties of the Aloha Tower development corporation to the
19 Hawaii community development authority and the remaining rights,
20 powers, functions, and duties relating to the harbors
21 modernization group to the harbors division of the department of
22 transportation.

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B. NO.

1 SECTION 4. Chapter 206J, Hawaii Revised Statutes, is
2 repealed.

3 SECTION 5. All rights, powers, functions, and duties of
4 the Aloha Tower development corporation are transferred to the
5 Hawaii community development authority and the department of
6 transportation.

7 All officers and employees whose functions are transferred
8 by this Act shall be transferred with their functions and shall
9 continue to perform their regular duties upon their transfer,
10 subject to the state personnel laws and this Act.

11 No officer or employee of the State having tenure shall
12 suffer any loss of salary, seniority, prior service credit,
13 vacation, sick leave, or other employee benefit or privilege as
14 a consequence of this Act, and such officer or employee may be
15 transferred or appointed to a civil service position without the
16 necessity of examination; provided that the officer or employee
17 possesses the minimum qualifications for the position to which
18 transferred or appointed; and provided that subsequent changes
19 in status may be made pursuant to applicable civil service and
20 compensation laws.

21 An officer or employee of the State who does not have
22 tenure and who may be transferred or appointed to a civil



B. NO.

1 service position as a consequence of this Act shall become a
2 civil service employee without the loss of salary, seniority,
3 prior service credit, vacation, sick leave, or other employee
4 benefits or privileges and without the necessity of examination;
5 provided that such officer or employee possesses the minimum
6 qualifications for the position to which transferred or
7 appointed.

8 If an office or position held by an officer or employee
9 having tenure is abolished, the officer or employee shall not
10 thereby be separated from public employment, but shall remain in
11 the employment of the State with the same pay and classification
12 and shall be transferred to some other office or position for
13 which the officer or employee is eligible under the personnel
14 laws of the State as determined by the head of the department or
15 the governor.

16 SECTION 6. All appropriations, records, equipment,
17 machines, files, supplies, contracts, books, papers, documents,
18 maps, and other personal property heretofore made, used,
19 acquired, or held by the Aloha Tower development corporation
20 relating to the functions transferred to the Hawaii community
21 development authority and the department of transportation shall
22 be transferred with the functions to which they relate.



B. NO.

1 SECTION 7. All rules, policies, procedures, guidelines,
2 and other material adopted or developed by the Aloha Tower
3 development corporation to implement provisions of the Hawaii
4 Revised Statutes which are reenacted or made applicable to the
5 Hawaii community development authority or the department of
6 transportation by this Act, shall remain in full force and
7 effect until amended or repealed by the Hawaii community
8 development authority or the department of transportation
9 pursuant to chapter 91, Hawaii Revised Statutes. In the
10 interim, every reference to the Aloha Tower development
11 corporation or the chairperson of the Aloha Tower development
12 corporation in those rules, policies, procedures, guidelines,
13 and other material is amended to refer to the Hawaii community
14 development authority or the department of transportation or the
15 chairperson of the Hawaii community development authority or the
16 director of department of transportation as appropriate.

17 SECTION 8. This Act shall take effect upon its approval;
18 provided that sections 4, 5, 6, and 7 shall take effect on July
19 1, 2011.

20

INTRODUCED BY: _____



B. NO.

B LRB 10-0608.doc



B. NO.

Report Title:

Aloha Tower Development Corporation; Repeal

Description:

Repeals the Aloha Tower Development Corporation and transfer its powers and duties to the Hawaii Community Development Authority and the Harbors Division of the Department of Transportation. Requires the agencies to develop a plan, including proposed legislation, to effectuate the transfer.

The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.



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Responses of the Affected Agencies

Comments on Agency Responses

We transmitted a draft of this report to the board of directors of the Aloha Tower Development Corporation and the corporation's chief executive officer on March 31, 2010. A copy of the transmittal letter to the agency is included as Attachment 1. A similar letter was sent to the board. The agency's response includes ten exhibits. The response, without the enclosed exhibits, is included as Attachment 2.

The exhibits attached to the agency's response include: correspondence with the Auditor's office; the corporation's March 31, 2010 strategic plan; excerpts from the corporation's 2005 to 2009 annual reports; a list of harbors modernization plan contracts; letters to the editor and commentaries written by corporation staff and the board's chairman; January 12, 2010 meeting notes from a meeting attended by the corporation and the U.S. Coast Guard-Facilities Division; and a letter in support from a director of the Harbors Modernization Group. Upon review, we determined that the exhibits were not material to the agency's response. Hence, they are not included as an attachment to our report.

In its response, the corporation objected to our audit "criticiz[ing] development initiatives at the Aloha Tower project area from the inception of plans . . . through each successive administration" and "condemning the current Board and staff who have tenures of five years of less for actions long past." The corporation misses our point. The corporation's core mission is to redevelop the Aloha Tower Project Area. After 30 years of effort, little development progress has been made and the corporation has fallen far short of its core mission to redevelop the Aloha Tower Project Area. Although the corporation attempts to deflect responsibility, it does not dispute these facts.

The corporation also does not dispute that its litigation costs total \$2.4 million. It asserts, however, that the State's attorney general may pay the \$136,000 in attorneys' fees and costs in the Irwin Memorial Park case. The corporation again misses our point. Whether litigation costs are paid from a special fund or the State's general fund, the costs are paid with state funds that could be used for purposes other than litigation. Further, the corporation argues that the \$1.55 million stipulated settlement in the Hughes case is somehow "favorable" to the State because Hughes was asking for much more. This argument is misguided. We disagree that a \$1.55 million settlement against the State is favorable. Payment of the settlement drains moneys from the corporation's special fund that are needed for redevelopment.

The corporation disagreed with the report's recommendation to transfer the functions of the corporation to the Hawai'i Community Development Authority and return the Harbors Modernization Plan to the Department of Transportation-Harbors Division (DOT-Harbors). Although the corporation agreed that problems identified by our office in 1987—that there is an inherent conflict between redevelopment of the project area and maritime uses, and the corporation's pursuit of unrealistic financing strategies remain unaddressed—it deflects blame by saying that the solution to these constraints “will require political will and funding resources.” The corporation fails to acknowledge, however, that it has been ineffective at securing the support and funding it needs for development. Further, the corporation agrees that the State has not realized the financial returns that were based on completion of all phases of the original project, but wonders why it should be blamed for a developer's failure to meet projections. As the agency responsible for the development of the Aloha Tower Project Area, we find that the corporation should be held accountable for its selected developer and for the successes or deficiencies of subsequent developments.

The corporation claims it launched initiatives to address development constraints through its recently approved strategic plan. Although the corporation is moving in the right direction by adopting a strategic plan, it must ensure that its new plan meets the requirements of a strategic plan, such as measurable outcomes and timed elements. In fact, we note a flaw with the plan, which we pointed out in our report. The corporation's primary course of action is to hire yet more consultants to study options for redevelopment and parking alternatives, including a development plan and project area rules. In our report, we found that the corporation has already wasted at least a decade and a total of \$188,000 on two consultants to update its development plan and rules.

Further, the corporation calls our hypothesis questioning the viability of project area development “erroneous.” We assert that the corporation's consultation with the U. S. Coast Guard without a detailed development plan is premature. In fact, the corporation admits it must file Facilities Security Plans for new developments, of which it has none. We wonder how the corporation can conclude that a project is possible within security constraints when it is unclear what the corporation plans to develop.

The corporation now tries to justify its existence with recently added harbors work. It seeks to discredit our statement that the legislative conference committee expressed doubts about the corporation's management abilities and moved to restore the harbors modernization responsibilities to the DOT. The corporation errs in its reference to “a 2009 conference committee report by Senate Ways and Means Committee on House Bill 200.” In fact, the report was the work of a

powerful legislative conference committee on House Bill 200 (which became the General Appropriations Act of 2009, Act 162, Session Laws of Hawai‘i 2009). The corporation’s questioning of this conference committee’s report illustrates the corporation’s lack of understanding of the legislative process. A legislative conference committee is made up of members from both houses and the final conference draft of a bill that becomes law reflects the will of the Legislature. We also noted that the General Appropriations Act of 2009, which began as House Bill 200, funded the corporation for only the first year of a two-year biennium, which sends a strong message of concern to an agency.

The corporation also disagrees with our recommendation for the orderly transfer of the rights, powers, duties and functions of the Harbors Modernization Group (HMG) to the DOT-Harbors because our report did not include an assessment of the corporation’s performance for recently added harbors work. While the corporation has featured harbors work prominently in its recent annual reports (while also repeatedly saying it needed to update its plans and rules), we focused on the corporation’s inability to execute its core mission to redevelop the Aloha Tower complex. In fact, we found that the HMG is not needed because the Department of Transportation is in charge of harbors improvements and controls all funding and planning of harbors work. The corporation was asked to assist DOT-Harbors with implementation and to provide an additional source of funding, which is not needed. In addition, our recommendation is meant to prevent any disruption of important harbors work as it calls for the corporation and the DOT to develop and submit a plan for the orderly transfer.

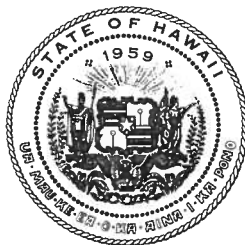
We also stand by our finding that redirection of corporation revenue to harbors work may starve efforts to redevelop the Aloha Tower Project Area. The corporation stated, “The idea of redirecting ATDC funds to harbor infrastructure projects was based on using funds in excess of monies needed to fulfill ATDC’s mission.” We question whether the corporation has ever known how much money it needs to fulfill its mission as all it has to show today is mounting litigation expenses, an outdated master plan, and an underperforming marketplace.

Finally, the corporation states that it “has improved its management functions and have [sic] great plans moving forward.” However, many of the so-called “management improvements” in its response, such as conducting and documenting regularly scheduled board meetings, are statutorily mandated duties and have little direct effect on redevelopment. Rather than an improvement, we view these so-called management improvements as matters of compliance with the State’s Sunshine Law.

Ultimately, the corporation faults our recommendations for not providing solutions. On the contrary, we stand behind our solutions, which are

to repeal the corporation and transfer its duties and responsibilities to agencies that can make progress. Although our final report contains a few minor editorial changes for purposes of accuracy and style, we stand by our report and its recommendations.

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917



MARION M. HIGA
State Auditor

(808) 587-0800
FAX: (808) 587-0830

March 31, 2010

COPY

The Honorable Sandra Pfund
Chief Executive Officer
Aloha Tower Development Corporation
700 Bishop Street, Suite 1701
Honolulu, Hawaii 96813

Dear Ms. Pfund:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Management Audit of the Aloha Tower Development Corporation*. We ask that you telephone us by Thursday, April 1, 2010, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, April 5, 2010.

The Board of Directors of the Aloha Tower Development Corporation, Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

A handwritten signature in cursive script, appearing to read "Marion M. Higa".

Marion M. Higa
State Auditor

Enclosures



ALOHA TOWER DEVELOPMENT CORPORATION

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LINDA LINGLE
 Governor
 SIDNEY A. QUINTAL
 Chairperson
 SANDRA PFUND
 Chief Executive Officer

Refer to: 2010.042

April 5, 2010

RECEIVED

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VIA FACSIMILE AND HAND-DELIVERY

To: Marion M. Higa, State Auditor
 State Of Hawaii – Office of the Auditor

OFC. OF THE AUDITOR
 STATE OF HAWAII

From: Sandra Pfund, Chief Executive Officer *Sandra Pfund*
 Aloha Tower Development Corporation

Subject: Response to the Draft Audit Report, *Management Audit of the Aloha Tower Development Corporation*

The Aloha Tower Development Corporation (ATDC) received the draft report on March 31, 2010. The ATDC was given just two business days to provide its response. The ATDC requested an extension of time until April 16, 2010 to be able to distribute the draft to its Board of Directors, permit time for their review and to call a special board meeting, as requested by the Chairperson, in order to afford the Board an opportunity to have a collective discussion on the draft and its response. You denied our request for an extension without explanation. We have attached our request and your denial for the record as Exhibits A and B. Consequently, we have prepared this rushed response and reserve the right for our Board of Directors and the corporation to make additional comments.

Summary Response:

- The audit criticizes development initiatives at the Aloha Tower project area from the inception of plans to revitalize the Honolulu Waterfront by Governor Ariyoshi in 1978 through each successive administration. This time frame spans a myriad of Board members and staff over 30 years. The report notes that ATDC should not be given any more chances and is condemning the current Board and staff who have tenures of five years or less for actions long past. We need to focus on today and the future.
- The solution lies in resolving the fundamental constraints to development, and this will require political will and funding resources. The Auditor falls far short in her recommendation, which is to simply transfer the functions of the ATDC to the Hawaii Community Development Authority (HCDA). The Auditor cites HCDA's greater development authority but at the same time describes both agencies as similar, and as we

provide in our detailed response, the Auditor's position is misleading and inaccurate. The ATDC and HCDA differ greatly in its mission objectives and constituency.

- To support her position for the transfer to HCDA, the Auditor states that the HCDA has completed many projects and touted significant private investment in Kaka'ako. What is not stated is that there has been over \$155 million dollars of taxpayer investment into Kaka'ako for public infrastructure which in turn fueled private investment.¹ The Aloha Tower project area has not received any capital improvement funds despite requests to the Legislature in 2005 and 2009.
- The audit further describes key constraints to development over the span of 30 years as the primacy of Department of Transportation maritime activities, spatial constraints and the need to reassess financial models where private developers are expected to fully fund development including common area infrastructure. The ATDC concurs with the identified constraints. The ATDC has launched initiatives to address these constraints by significantly improving collaboration with the DOT and partnering on their development efforts, addressing spatial constraints as shown in the ATDC Strategic Plan (Exhibit C) and seeking capital improvement funds for public infrastructure.
- The current Board and staff have focused on cleaning up long-standing litigation and unresolved debt obligations that have hampered the Corporation's ability to move forward. We have restructured the ground rent payments with DOT and collaborated on an equity participation option so that the DOT can benefit from revenue gains. The three lawsuits that the Auditor has criticized the agency for were obligated in the past; two are resolved and one is in mediation and close to settlement. Although the ATDC had to pay a settlement award in the recent Hughes case and was heavily criticized for it, the fact is that the developer sought over \$35 million in damages and the ATDC was able to settle the case at \$1.55 million. Most importantly, Hughes has no rights to the property despite an earlier agreement giving Hughes exclusive development rights. The Arbitrator found, among other things, that Hughes could not have completed the development. The ATDC has tackled its problems head on and refuses to let problems linger.
- The Auditor has really fallen short in its assessment that the ATDC cannot justify its continued existence through harbors work and asserts a lack of "expertise." It is amazing to us that the audit does not include an assessment of the performance of the Harbors Modernization Plan to justify its position, leading to doubts on the credibility of this report. In 2007, the Legislature recognized the expedited accomplishments of the collaborative effort between the DOT and ADTC in the development of maritime infrastructure and passed a law to formalize the partnership for projects in Honolulu Harbor. In 2008, the Legislature extended this partnership to a comprehensive program for commercial harbors statewide. The Legislature refocused ATDC's mission by these policy directives and the accomplishments to date speak for themselves. See Exhibit D - List of Harbors Modernization Projects completed and in progress.

¹ Hawaii Community Development Authority 2008 Annual Report, Page 2

- The Auditor states that the Legislature’s confidence in the corporation’s ability has eroded on the basis of a 2009 conference committee report by Senate Ways and Means Committee on House Bill 200. However, it is silent on the milestone legislation passed in 2007 and 2008 placing its confidence in ATDC to carry forth a key role to support the DOT in its landmark Harbors Modernization Plan. Again, the Auditor provides a limited review and fails to provide a balanced perspective.
- The Auditor recommends that with respect to the ATDC’s role in the Harbors Modernization Plan, that role should be returned to the DOT Harbors Division and that the board members established under ATDC (includes the Budget Director, maritime experts and the Mayors of each county) for the Harbors Modernization Group be eliminated. The expert input and collaboration have been instrumental in the progress to date of the program. In essence, the Auditor is recommending that we return to the status quo despite the Legislature’s passage of initiatives in 2007 and 2008 that set public policy to address a crucial need that is critical to the economy of this State.
- The ATDC has improved its management functions and have great plans moving forward. The audit did not point to any irregularities in its financial reports, procurements or general management. The current Board and staff have made significant management improvements. It has passed corporate by-laws, conducts and documents regularly scheduled Board meetings, established a Public Advisory Group, updated its Rules of Practice and Procedure (pending final approval), had a financial audit of the Aloha Tower Marketplace (ATM) performed by a CPA firm, enforced lease provisions with ATM including submittal of annual rent calculations, updated its organizational chart and functional statements, established positions, prepared Yearly Activity Plans (which includes multi-year planning and evaluation) and has adopted a Strategic Plan. The Auditor is silent as to recognizing these improvements.

Detailed Response:

The ATDC herein below provides a page by page review of the draft audit report and responds to misstatements, inaccuracies, inflammatory statements and incorrect conclusions:

Page 1, 1st Paragraph, 1st Sentence: “This is the first audit of the Aloha Tower Development Corporation (ATDC) performed by the Office of the Auditor.”

This statement is erroneous and contradicts statements made later in the audit.

Page 1, 4th Paragraph, 2nd Sentence: “This area, located between Piers 5 and 14, is the primary focus of this report.”

Why does the audit omit ATDC’s full jurisdiction which also includes land in the Iwilei area? With the mass-rapid transit system set to start construction later this year, there is tremendous development potential for the areas within ATDC’s entire jurisdiction. ATDC will play a major role in the transit-oriented developments in the Downtown and Iwilei areas since two prime mass transit stops are located in ATDC’s jurisdiction.

Page 4, 2nd Full Paragraph, Last Sentence: “Of those ten, only four employees had been hired to fill the 18 approved positions for the Harbors Modernization Group.”

This statement is misleading. ATDC’s ability to fill the 18 positions was restricted by DOT funding and approvals to 7 positions currently. This reduction was based on prudent management of the program since the Harbors tariffs needed to be first increased by Hawaii Administrative Rules in order for revenue bonds to be floated for the Harbors Modernization Plan. The DOT and the Department of Budget and Finance approved a \$16.735M cash advance for the program to begin planning and design projects. Significant design contracts have been issued under the advance with construction to begin in late 2010. The revenue bonds are expected to be issued to coincide with the construction schedule due to the successful adoption of tariff increases by DOT-Harbors in early 2010. Additional position authorizations will be proposed to meet the workload in the next biennium budget cycle. ATDC also worked expeditiously to establish and obtain approvals for the ATDC/HMG organizational chart and the establishment of the HMG positions, no small task in the time frame that it was accomplished.

Page 4, 4th Full Paragraph, Last 4 Sentences: “Without a development agreement in place, the corporation became responsible for payments starting in 2000. Effective July 1, 2004, future reimbursements were reduced to \$225,000 annually. Effective July 1, 2005, the reimbursement was reduced by the salaries of two corporation employees who performed harbors-related work. As of June 30, 2008, the corporation owed DOT approximately \$7.7 million for lost revenues.”

While factually correct, the tone of this Paragraph appears to mislead the reader. After many years of impasse with respect to restructuring the DOT-H reimbursement for lost revenues, ATDC’s current staff worked with DOT-H staff to stop the unchecked accruals and set the annual reimbursements at \$225K per year plus an equity sharing option. This agreement between DOT-H and ATDC is a tremendous accomplishment which can be attributed to the increased collaboration between the agencies.

Page 9, 2nd Paragraph, 2nd Sentence: “In 2006, ATDC approved Hughes’ proposal for residential units, a boutique hotel, public infrastructure, and parking, subject to agreement over key issues, including ground lease rent and parking.

This statement is misleading as the ATDC Board of Directors *conditionally* approved Hughes’ proposal. Hughes never met all of the conditions set by ATDC’s Board of Directors in its conditional approval and never executed a Project Component Development Agreement. Not only were the appraised value of the land and parking requirements unresolved, but Hughes also wanted to pay the lease rent at a discounted value, “up front” and at the closing of the units (after units were completed). This would have left ATDC in a very perilous situation.

Page 9, 2nd Paragraph, Last Sentence: “The arbitrator issued a decision in favor of Hughes in April 2009, which was confirmed by a federal judge in September 2009.”

The federal court vacated its order confirming the arbitration award.

Page 13, 4th Paragraph, Last Sentence: “And, even though steps were taken in 2004 to expand ATDC’s responsibilities to include harbors modernization work, we found that reasons for this expansion were not compelling.”

This conclusion apparently ignores all of the compelling reasons why the Legislature decided to create the Harbors Modernization Group and statutorily attach it to ATDC in 2007 for Honolulu Harbor and in 2008 for a statewide authorization. It is troublesome that the Auditor appears to believe her judgment is paramount to the Legislature’s judgment.

Beginning in 2004, the maritime industry began to organize itself as a non-profit group of key harbor users to develop priorities for port development and address the looming shortage of port facilities in the islands. It was projected in 2005 that Honolulu would run out of space for international cargo that year and domestic cargo in 2010. See – Hawaii Harbor Users Group (HHUG) Report on Port Facilities & Development Priorities, Mercator Transport Group, December 2005.

HHUG initiated an effective lobby to the Administration, Legislature and media to publicize their collective prioritized needs. The Administration, understanding the importance of the harbors as Hawaii’s economic lifeline established a Task Force, partnering ATDC with DOT-Harbors to expedite improvements. This partnership was so successful that the Legislature, who also recognized the importance of harbors, statutorily authorized it in 2007 and 2008.

The Auditor did not include an assessment of the performance of the partnership and the many projects that have been completed or are in progress at this time.

Page 14, 1st Full Paragraph, 4th Sentence: “Its 2001 Land Court petition to remove parking restrictions on Irwin Park to allow construction of a parking garage failed, leaving the corporation liable for all parties’ costs.”

This matter has been resolved. This statement is erroneous and misleading.

According to the Office of the Attorney General, a Final Judgment has been entered in Land Court on March 29, 2010. The Judgment represents Respondent’s attorney fees and costs which the Respondent argued was owed to them under the Private Attorney General doctrine. Because the Court agreed that this doctrine applied, the ATDC believes that the Office of the Attorney General will take responsibility for the payment.

This rebuttal statement is applicable to other erroneous statements later in the audit (i.e., Page 15, 4th Paragraph; Page 17, 1st Full Paragraph) claiming ATDC is responsible to pay the approximately \$136K in attorney’s fees and costs.

Page 16, 2nd Full Paragraph, 2nd and 3rd Sentences: “The corporation subsequently entered into a predevelopment agreement in 2003 and development agreements in 2004 and 2006 with Hughes. The Aloha Tower Development Corporation’s board members said that it did not seek other

development proposals for any part of the Aloha Tower Project Area after that because they decided the question of Hughes' development rights needed to be resolved.”

ATDC did not enter into a 2006 development agreement with Hughes. The conditional approval clearly required execution of a Project Component Development Agreement for the Piers 5 & 6 development.

The 2004 Development Agreement with Hughes gave him exclusive development rights for Piers 5&6 through 2009. The current ATDC Board was obligated under this agreement to permit Hughes the right to propose a development project, which it did, but included numerous conditions that Hughes must meet to ensure the project was feasible before it agreed to execute a Development Agreement and Lease. Hughes also sought development rights to Piers 10 &11 during this timeframe which the ATDC Board declined until it was proven that Hughes could perform on Piers 5 & 6. The ATDC Board correctly voted to give Hughes only a conditional approval of a proposal at Piers 5&6.

Page 16, 3rd Full Paragraph, 1st Sentence: “In April 2009 an arbitrator ruled in favor of Hughes and said the manner in which the corporation negotiated, or failed to negotiate, constituted a breach of good faith and fair dealing.”

The Arbitrator's ruling included findings for and against both parties.

ATDC argues the Arbitrator created a new standard for *the manner in which the corporation negotiated or failed to negotiate* constituted a breach of good faith and fair dealing recognized by Hawaii's courts. He found in ATDC's favor on the key issue that ATDC did act in good faith.

Furthermore, the audit does not mention the Arbitrator also found the following to be true about Hughes proposed project with which ATDC agrees:

- **If the manner of determining rent was based upon the common method of the return on the fee interest, it is highly probable that Hughes would not have proceeded with the project as it would not have been commercially viable;**
- **The evidence did not show that Hughes could have secured adequate financing;**
and
- **Hughes did not prove that there was any market for the product.**

Page 16, 4th Paragraph, 2nd sentence: “In December 2009, a federal judge approved a stipulated judgment and settlement of \$1.55 million for Hughes, to be paid by the corporation.”

The Auditor fails to mention that Hughes was initially seeking \$35.2 Million in Expectation Damages, Detrimental Reliance Damages and Restitution Damages as well as unspecified Taking of Vested Rights and General Damages. The Arbitrator determined that Hughes had no vested rights and therefore the site is free of any encumbrances in favor of Hughes.

The ATDC Board and the Attorney General both agreed to utilize private legal counsel specializing in development litigation due to the significant claim. The Arbitrator's award is deemed very favorable to the State in perspective.

Page 17, 2nd Full Paragraph: "In addition to the corporation's direct legal costs, there are intangible costs such as the effect of negative publicity. For example, Hughes is a developer with a national reputation and a member of the Board of Governors of the Urban Land Institute. Recent articles and editorials by local media describe the Hughes arbitration with headlines such as *Tower of Trouble*, *Aloha Tower needs better development*, and *State's Aloha Tower agency should be fired*, which do not enhance the corporation's or State's reputation. Negative publicity may be damaging and, when combined with the corporation's extensive history of litigation, may undermine the willingness of future private developers to partner with the State. The corporation's own attorneys have argued that the arbitrator's award in favor of Hughes should be vacated because it infringes on the discretionary function of state development agencies and will have a chilling effect of future development projects in the State."

The audit fails to recognize the media articles and letters to the editor rebutting the one-sided and biased statements made in the articles mentioned in the audit. Attached for your review and consideration are Exhibits E, F, G and H which were published September 17, 2009, September 23, 2009, September 25, 2009 and October 2, 2009, respectively.

Notwithstanding the negative publicity, the current ATDC Board and staff did what if felt had to be done to protect the State's interest in a development proposal that had significant feasibility concerns.

Pages 17-18, 3rd Full Paragraph: "An ambitious \$590 million development proposal by Aloha Tower Associates in 1989 envisioned a multi-component project for the Aloha Tower Complex. Twenty years later, only the first phase was completed, leaving the Aloha Tower Marketplace to struggle without its component parts. Alone, the marketplace generated far less than was expected and was unable to realize its projected financial benefits for the State. The completed project, which was later split into phases, was projected to earn over \$4 billion over 65 years. After 30 years and with only the marketplace to show for its development effort, the corporation has fallen fall short of its core mission to redevelop the Aloha Tower Project Area."

The inability to achieve full build out of this project has led to numerous residual problems that we are dealing with today. The current ATDC Board and staff understand what needs to be done going forward and is taking positive steps toward an achievable plan.

Why is ATDC to blame for a past private developer's failure to meet its projections? Why is ATDC to blame for worldwide economic downturns? What could ATDC have done to salvage the development agreements without jeopardizing its landlord-tenant relationship?

Page 17, 3rd Paragraph, last sentence: "The corporation's own attorneys have argued that the arbitrator's award in favor of Hughes should be vacated because it infringes on the discretionary function of state development agencies and will have a chilling effect on future development projects in the State."

ATDC's attorneys were referring to the Arbitrator's award as it related to the award of pre-award and post-award interest that the State argues infringes on the State's sovereign immunity. The federal court vacated its confirmation of the award and eliminated any legal precedent the confirmation may have set.

Page 20, 4th Paragraph: "Lacking other development phases at the Aloha Tower Complex, the marketplace is struggling. Moreover, once Aloha Tower LP acquired bankrupt Aloha Tower Associates' lease in 1998, all of the original developer's proposed benefits evaporated. The State was not able to realize Aloha Tower Associates' projected total of \$4 billion to be paid to the corporation over the 65-year lease; an estimated \$56 million in public benefits to the State; and estimated \$44 million in donations to an Enterprise Housing Fund, to be set up for the provision of affordable housing; and an upfront \$60 million lease premium."

We agree that the current ATDC Board and staff are living with the residual effects of a project that was based on financial returns that did not materialize. One of those expectations was loss revenues payable to DOT in an amount that significantly exceeded lease rent returns on what was actually built. The ATDC restructured the rent going forward as of 2005, but DOT could not waive past receivables on their accounting records. The Auditor is recommending that HCDA resolve this problem. Is the Auditor recommending that DOT write off this amount or does it expect HCDA to create new development and burden a developer to pay this amount, which is not reasonable as the Auditor clearly notes in this report.

Page 21, 2nd Full Paragraph, 2nd Sentence: "Problems identified by the Auditor in 1987, including an inherent conflict between redevelopment of the project area and maritime uses, and the corporation's pursuit of unrealistic financing strategies, remain unaddressed."

We agree with these findings and have taken steps to address these issues. Again, we cannot agree with the Auditor's solution to simply transfer the corporation to HCDA. It would not be fair to HCDA without looking to address the root issues and offering powers to solve them.

Page 21, 2nd Full Paragraph, 3rd Sentence: "Moreover, with the passage of time, the events of 9/11 and the resulting harbor security and restrictions, development of the project area may no longer be viable."

This statement is erroneous. ATDC has consulted with the DOT-H, U.S. Coast Guard among other stakeholders and concluded a viable development is possible within the Aloha Tower Project Area. The key issue for maritime security is the proximity of the ship to land side activity during loading and unloading of vessels. The U.S. Coast Guard Facilities Division has guidelines for development and has assured us that as long as a project is designed with the maritime guidelines in mind, a successful project is certainly possible. Additionally, the U.S. Coast Guard is a partner with us and are included in all design consultations for our projects.

Attached as Exhibit I are meeting notes of our meeting with the U.S. Coast Guard regarding development concepts within the ATDC jurisdiction.

Page 21, 2nd Full Paragraph, 4th Sentence: “With little to show for its development efforts and no projects on the horizon, the corporation now justifies its existence with recently added harbor infrastructure improvement work, which has little to do with its core mission to develop the Aloha Tower Project Area.”

Please refer to ATDC’s Strategic Plan that was adopted by the ATDC Board of Directors on March 31, 2010. Based on the development framework presented in the Strategic Plan, this statement is patently erroneous.

Page 21, 2nd Full Paragraph, 5th Sentence: “Moreover, a 2009 legislative conference committee found the corporation was unable to effectively lead the harbors modernization.”

We are amazed at this conclusion for reasons already stated in this response.

The Legislature is comprised of 76 members. Certainly, there will be differences of opinion on many things. The true test of the Legislature’s intent is what legislation is actually passed into law.

Page 21, 3rd Full Paragraph, 2nd Sentence: “We also found that financing strategies pursued by the corporation with its developers have been unrealistic and unworkable.”

The current ATDC Board and staff agree that placing an unreasonable burden on private developers for public infrastructure is not a financing strategy that works. The solution is CIP funding as provided to HCDA or the ATDC would need to discount its return on land to the developer to fund the public infrastructure.

ATDC wants to clarify that the current ATDC Board and staff looked at the Hughes proposal in this way. However, ATDC found that Hughes wanted a significant discount on the land but at the same time was unwilling to fund public parking beyond that needed for his development.

Page 22, 3rd Paragraph: “While the partially developed site’s use is now shared between non-maritime and maritime activities, the DOT’s maritime operations continue to significantly impact the economic feasibility of the project area’s development. In fact, the corporation’s demonstrated preference that developers pay for DOT’s losses in revenues and replacement DOT facilities may strain developers financially.”

Without CIP appropriations and/or DOT-H’s waiver of its requirements, ATDC’s hands are tied. The audit does not provide any recommendations that will effectively resolve these constraints.

Page 22, 4th Paragraph, 4th sentence: “We pointed out that the Aloha Tower site is not characterized by obsolescence or blight; rather, it is the focal point of Honolulu Harbor, the most active and important port in the state harbor system.”

ATDC concurs. However, both the Hawaii Harbors Users Group and the Department of Transportation Harbors Division have affirmed that the Aloha Tower Project Area is not conducive for industrial maritime use, i.e. cargo operations. And, as the Auditor indicates, it is the focal point of Honolulu Harbor and should be improved as a maritime gateway to central Honolulu.

Page 22, Last Paragraph (continues on to Page 23): “In our 1987 audit we found that financing strategies for the project were unrealistic and unworkable because of the faulty development concept. It was unrealistic for the State to require a private developer to carry the cost of the entire project, including public and private improvements. Because public improvements—such as parks and pedestrian malls—do not generate revenue, the financial feasibility of a project becomes questionable as the demand for public improvements increases. Yet, even knowing this, the corporation persists in seeking developers who will commit to all or substantially all of the costs of development.”

ATDC agrees with these statements. However, ATDC has requested CIP funds to fund infrastructure improvements such as parking improvements, but the CIP was not appropriated.

Page 24, 2nd Full Paragraph: “Today more than 20 years since our 1987 report addressed the corporation’s financing strategy, the corporation’s rules still contain a development objective encouraging the developer to bear all or most of the costs. Unless the corporation reassesses its financing approach and considers other financing alternatives—such as the former DPED director’s idea to use public funds to develop public improvements—or offers nominal rentals in exchange for private financing as allowed in the law, redevelopment of the project area will continue to stall. Even the corporation has recognized that financial viability has been a challenge and that it must continue to look for other development options to bring about necessary redevelopment.”

ATDC has sought CIP funds to pay for public improvements in 2005 and 2009.

Page 24, 3rd Full Paragraph, 3rd & 4th sentences: “With an obsolete master plan and without an approved strategic plan, the corporation may be unaware of and unable to overcome development constraints. In the end, development of certain commercial, residential, and hotel uses at the Aloha Tower Project Area may no longer be viable.”

After many months of public input and internal discussions, the ATDC Board approved the ATDC Strategic Plan in March 2010. ATDC transmitted drafts of the plan to numerous stakeholders and governmental agencies and held meetings with various entities including its Public Advisory Group.

The advent of the planned Downtown and Chinatown Mass Transit stops within ATDC's jurisdiction presents a new and expanded level of development potential for the areas adjacent to the transit stops. ATDC's regulatory authority over these areas provides an extraordinary advantage for such development opportunities,

Page 25, 2nd Paragraph, Last Sentence: "Such deals require subsidies, incentives and/or landlords' potential participation in tenants' business success to make them work; the necessary combination of these requirements did not appear to be likely to occur in the foreseeable future."

This statement is overly broad. ATDC must be wary of jeopardizing its landlord-tenant relationship with its tenant as it may become liable for all obligations of any partnership.

Page 25, 3rd Paragraph, Last Sentence: "Theme and water parks featuring the waterfront location were potential entertainment uses, but the land comprising Piers 5-14 is probably not large enough for such uses."

The current ATDC staff concurs with expanding the land area but would have concerns with this recommendation. Our public commitment includes mauka-makai view corridors public access and financial prudence to ensure feasibility of maintenance costs.

Page 25, 4th Paragraph, Last 2 Sentences: "Residential use would hinge upon the State's ability or willingness to sell its fee simple interest in the land covering Piers 5-14 area. Development of condominium units would likely require the state to sell its interests in the land; nor are rental apartments financially feasible unless the state or other some other public entity subsidized the development."

ATDC introduced legislation in 2005 to authorize ATDC to sell land in fee simple. The measure did not advance beyond the subject matter committees.

ATDC concurs that rental apartments would not be feasible unless they were high-end. Developers had proposed this concept at HCDA but the project has not progressed as far as we know.

Page 26, 3rd Paragraph: "The corporation did not provide a uniform explanation for its decision not to extend Towill's contract or enable the consultant to provide a final and more fully-developed report. The former corporation board chair first told us that the corporation was "not fully satisfied" and, in her opinion, may not need another consultant. However, a report signed by the CEO reflects a completely different view. The report states the corporation was indeed satisfied with Towill's performance."

The Auditor cites this as an example that the ATDC Board and staff are conflicted in terms of moving forward with development planning. This is simply not the case and more a situation where the Auditor does not understand required contract processing. The ATDC Board determined that it would not continue with the Towill contract. The CEO then notified Towill of the termination and worked with Towill to ensure that all deliverables required under the contract up to the time of termination were performed and delivered.

Once all contract requirements were satisfactorily met, the CEO signed a required form to process payment, *Contract Administration Verification Report* that stated that the contract requirements were satisfactorily met to the point of contract closure. The form dated February 16, 2007, notes the CEO's comment that "ATDC will build on the Contractor's work with respect to the Aloha Tower Project Area Plan. The summary was presented to the ATDC Board of Directors and based on their direction, further actions will be taken."

The ATDC Board of Directors and staff work closely and collaboratively.

Page 27, 1st Full Paragraph: "The corporation has known since 1999 that its master plan and administrative rules are outdated and that this has affected its ability to accomplish its mission. Yet, even with two opportunities and professional advice from credible consultants, it has shirked its responsibility to complete this vitally important task. In its folly, the corporation has wasted both time—ten years—and money—a total of about \$188,000 (\$130,000 and \$58,000 to Group 70 and Towill, respectively) and still does not have an updated master plan or rules. The corporation should not be afforded a third opportunity to hire yet another consultant to complete these tasks."

The current ATDC Board and staff have moved forward with a number of recommendations from its studies. These studies were not wasted. Some recommendations that are being acted upon include:

- **Development proposals were sought based upon recommended "highest and best use" product – condominiums.**
- **Increase of critical mass through special events and seeking DOT-H approval to permit preferred berthing at Piers 10 & 11 since it is a much better venue than Pier 2 and creates vibrancy for the Aloha Tower Marketplace.**
- **Expand the developable area. This finding was adopted in ATDC's Strategic Plan.**
- **Sought CIP funding for public parking improvements.**
- **Relocation of the HECO Powerplant. A multi-agency task force was created in 2004-2005 under the Office of Planning to address issues. CIP funding for studies was requested in 2005 but was not approved. This still remains a long-term goal for the ATDC.**
- **Improved communications and collaborations with the DOT-H.**
- **Improved community consultation and formed the ATDC Public Advisory Group.**
- **Update of the development plan and rule amendments. The Rules of Practice and Procedure have been completed and the ATDC has completed the Strategic Plan which will form the basis for development plan updates.**

Page 27, 2nd Full Paragraph: "The terrorist events of September 11, 2001 render commercial, residential, and hotel uses at the project area even less viable. One of the federal government's responses to 9/11 attacks was the Maritime Transportation Security Act of 2002, which is a broad range of programs for the security of vessels, ports, and waterways. Because the Aloha Tower Project Area is located on the waterfront, maritime restrictions will likely further limit the economic feasibility of development alternatives by making it difficult, if not impossible, to

build hotel, office or residential structures on the waterfront, particularly where there are cruise ship terminals. In fact, restrictions have already impacted parking.”

Detailed and timely discussions with DOT-H, the U.S. Coast Guard and the Department of Homeland Security will properly vet any development concept. ATDC believes a financially viable project can be developed.

Page 28, 1st Full Paragraph: “Given this, it is unlikely that Aloha Tower Project Area development can proceed under any plan and rules that predate the events of 9/11. And because the corporation’s plans and rules date to the 1990s, the corporation does not know whether development will be more difficult or even virtually impossible given the changes that have occurred post-9/11.”

This conclusion is overly broad and appears to be based on pure conjecture. Detailed and timely discussions with DOT-H, the U.S. Coast Guard and the Department of Homeland Security will properly vet any development concept. ATDC believes a financially viable project can be developed.

Page 29, 1st Full Paragraph: “As a result of our inquiry, at an April 2009 board meeting, the former chair raised the idea of initiating a board strategic planning session, and the corporation published its draft strategic plan in November 2009. Until a plan is approved that meets the requirements of a strategic plan, the Aloha Tower Development Corporation would be unable to carry out any updated master plan.”

In March 2010, ATDC adopted a formal Strategic Plan.

Page 29, 2nd Full Paragraph: “Beginning in 2004, steps were taken to expand ATDC’s responsibilities and involve the agency in a harbors modernization plan that extended beyond the Aloha Tower Project Area. The administration advanced two reasons in support of the corporation’s involvement: first, the harbors modernization effort needed the corporation’s development expertise; second, the effort also needed the corporation’s ability to enter into public-private partnerships to provide additional sources of funding. We found neither of these reasons compelling. The corporation’s unsuccessful development efforts at the Aloha Tower Project Area do not qualify as development expertise and DOT-Harbors’ approach to funding harbor infrastructure improvements does not contemplate private financing, thus negating any need to enter into public-private partnerships. Furthermore, any amended authority allowing redirection of corporation revenue (as contemplated by the corporation to fund its litigation obligations) could starve efforts to develop the Aloha Tower Project Area.”

The Auditor’s conclusions appear in direct opposition of the Legislature’s enactment of Act 200, SLH 2008 which created the statewide Harbors Modernization Plan (HMP) and expanded ATDC’s role in implementing the HMP.

Page 30, 2nd Full Paragraph, 1st Sentence: “First, the corporation’s development experience is limited, at best.”

This statement is short-sighted and fails to recognize the extent of the development and project management experience of the current staff and administration. The past “failures” of the ATDC should not be attributed to the current staff and administration.

Page 30, 2nd Full Paragraph, Last Sentence: “Moreover, the corporation has no expertise in harbors modernization and to suggest that it is suited to carry out such plans statewide is illogical and misguided, especially when its core mission since inception has been to develop the Aloha Tower complex in Honolulu Harbor.”

The Auditor omitted an assessment of the performance results to date of the Harbors Modernization Plan. It must be clearly understood that the ATDC works in close partnership with DOT-H staff and collectively we bring together harbor expertise, project management skills and most importantly, a program focused on an established 8-year plan.

Page 30, 3rd Full Paragraph (continues on to Page 31): “The expectation that the corporation could provide DOT with development expertise for the Harbors Modernization Plan hinges somewhat on the corporation’s ability to expeditiously fill 18 positions that have been approved for harbors work. As of July 2009, only four of those positions have been filled. Some of the delay is purposeful on the part of the corporation because legislation that would have eliminated the agency was considered in the 2009 session. The corporation’s chief executive officer stated at a recent board meeting that it would be unfair for more employees to come to the corporation with its future status unknown. Yet, the fact remains that as of 2009, the corporation has only a small portion of the expected personnel to carry out the Harbors Modernization Plan. The statute that establishes the partnership for harbors work will expire in 2016. This leaves the corporation little time to hire staff, and to implement statewide harbor infrastructure improvements prior to the sunset date.”

ATDC can only hire persons as approved by the DOT-H. ATDC has done its best with the resources it has been allotted and has made tremendous progress in implementing the HMP projects.

The Auditor also fails to mention the experience and background of current ATDC staff that were not originally involved in the Aloha Tower Project Area development problems that goes back through three previous administrations (Ariyoshi, Waihee and Cayetano).

The three current ATDC development staff has a combined experience of 70+ years in infrastructure and real estate development projects involving \$100’s of millions of dollars. They have worked diligently solve the problems handed to them and have made major headway into resolving the long standing legal issues. The staff assigned to the HMP projects also have a great deal of development experience and just as important, both the ATDC and HMG staff have extensive experience and knowledge of the State’s procurement and other regulatory practices and procedures. The staff is able to expeditiously process and guide all necessary documents through the myriad of approval levels. They have also forged the necessary contacts and established relationships with the various departments, agencies and personnel to successfully gain all the approvals necessary in a prompt manner.

Furthermore, an ATDC has hired a HMG administrative services officer and secretary who along with the three project managers on staff, have greatly advanced the HMP projects. ATDC also processed and obtained approval for the ATDC/HMG organization chart and plan and the attendant positions in an expeditious manner to quickly be able to hire the approved personnel and start work on the HMP projects.

Page 31, 1st Full Paragraph, 6th Sentence: “We disagree with the assertion by the director of business, economic development & tourism that eliminating the ATDC would seriously hamper adequate oversight of the harbor redevelopment projects.”

The progress ATDC has made on the HMP projects speaks for itself. Any disruption involving the personnel working on these projects will seriously derail all progress made with the existing and proposed planning, design and constructions contracts. Just as important are the working relationships established with DOT-Harbors, maritime users and statewide harbors stakeholders. Such relationships take some time to establish and even longer to gain trust and confidence in each other.

The Auditor should interview the various harbor users (e.g. Hawaii Harbors Users Group, Hawaii Pilots Association, DOT-H, etc.) and verify the positive working relationships ATDC has established.

Page 31, 1st Full Paragraph, Last Sentence: “On the contrary, we conclude that the corporation should not be involved in implementing harbor improvements.”

This statement is illogical and based on the author’s failure to recognize the progress ATDC has made in implementing the HMP projects.

Page 33, 1st Full Paragraph: “Although the Hughes development never came to fruition, these emails show that as early as July 2007 the administration was already planning to redirect funds from the Aloha Tower Fund to defray the cost of statewide harbor infrastructure improvements. If the Hughes deal had been completed at the State’s valuation, as much as \$50 million would have been available to apply towards harbor improvements statewide. We question whether redirection of the corporation’s mission and funds to harbor modernization comports with the corporation’s mission of redeveloping the Aloha Tower complex.”

The idea of redirecting ATDC funds to harbor infrastructure projects was based on using funds in excess of monies needed to fulfill ATDC’s mission. ATDC, as master lessee, is responsible for the lost of revenues to DOT-H for use of the Aloha Tower Project Area previously generating revenue for DOT-H.

One of the major issues related to Hughes’ deal was the disparity between the State’s valuation and what Hughes was willing to pay. Hughes also wanted to pay for the land “upon closing of the units” that would have placed the State in a high risk situation without any guaranteed compensation.

Page 33, 2nd Full Paragraph: “During the 2009 legislative session, the conference committee on House Bill 200, which became the General Appropriations Act of 2009, Act 162 (SLH 2009), expressed doubts about the corporation’s management abilities and moved to restore the harbors modernization responsibilities to the Department of Transportation.”

The Auditor failed to research why ATDC was chosen to work on the harbors modernization responsibilities in the first place. The corporation was fully backed by the harbors users groups and other stakeholders due to its previous work on various Honolulu Harbor projects that it completed successfully in an expeditious manner. The progress made (see Exhibit D) after the 2009 Legislative session speaks for itself and clearly demonstrates the corporation’s ability to manage the HMP projects.

Page 34, 1st Paragraph, 1st Sentence: “As expressed in its conference committee report on the General Appropriations Act of 2009, the Legislature’s confidence in the corporation’s ability has eroded. It did not view the corporation as the most capable body to lead the effort to modernize the State’s harbors. Instead, the Legislature restored this responsibility to DOT-Harbors. As the agency with statutory responsibility to establish, maintain, and operate transportation facilities of the State, including highways, airports, and harbors, the department also has the statutory responsibility to plan for the State’s transportation needs through its functional plan.”

Does the opinion of one conference committee count as the entire Legislature’s opinion? ATDC believes it does not. The final test is what legislation is passed into law.

Besides the previous statement above, the corporation has established a great working with DOT-H as evidenced by DOT-H’s own testimony and the knowledge of the hierarchy and relationships established at the working level is not to be taken lightly.

Page 34, 4th Paragraph: “To allow for an orderly transition, DOT-Harbors should work with the Aloha Tower Development Corporation to effectuate an orderly transfer of rights, powers, functions, and duties for statewide harbor improvements by June 30, 2011. Because the DOT already controls planning and funding of the Harbors Modernization Plan, harbors functions can be transferred without retaining the Harbors Modernization Group, which currently includes members of the Aloha Tower Corporation board.”

Recommending a “transfer without retaining the Harbors Modernization Group, which currently includes members of the ATDC Board”, shows the Auditor’s lack of knowledge of the inner workings of the ATDC/HMG Board and the major contributions, knowledge, insights and collaborative efforts of the entire Board, who represent each island, DOT-H and maritime users. Each member provides immeasurable value to the entire HMP project discussions and their critique, comments and recommendations at each step of the process provides immense value and cost savings for each harbor project. The monthly Board meetings provide a venue for continued discussion at each stage of the projects.

The DOT has consistently stated and testified at the Legislature that it must have a dedicated staff to oversee the Harbors Modernization Plan and has further stated and

testified that it would like to have the ATDC/HMG Board Members and ATDC staff attach to DOT if such a change was to be passed by the Legislature.

Page 37, 2nd Paragraph, 3rd Sentence: “In some instances, the authority’s statutory powers exceed those of the corporation’s, making the transfer a viable and attractive alternative with development benefits.”

The proposed transfer of ATDC to HCDA does not provide any real solutions. Without continuity and background knowledge of the related issues, such a transfer would only exacerbate the problems and issues and take much more time to be resolved.

Page 37, 2nd Paragraph, 4th Sentence: “For example, the authority can assess community districts for the costs of improvements and has the power of property condemnation.”

Improvement district assessments are utilized to assess private landowners for assisting in the cost of public infrastructure. In the ATDC project area focused upon by the Auditor (Piers 5-14) the land is wholly owned by the State. This tool does not apply to ATDC nor does the power of condemnation since the State would not condemn itself.

On the other hand, the ATDC has established Hawaii Administrative Rules to provide for subdivision authority of its property. This is a necessary tool for ATDC because the state lands under ATDC have never been permitted under the City and County of Honolulu. Without this subdivision authority, any development possibility would be virtually impossible because the City and County of Honolulu does not have jurisdiction of the area.

We reiterate that while ATDC and HCDA have similar authorities, there exists unique differences due to differing mission objectives and constituencies.

Page 38, Recommendations.

The Auditor’s recommendation does not include any real solutions to issues and problems described in the audit. The proposed changes only transfer the obligations of the corporation to other entities without addressing the issues and with the expectation the constraints ATDC faces will magically disappear.

Attached as Exhibit J is a rebuttal submitted by Captain Edward Enos, Jr. dated April 4, 2010. Captain Enos is a Director on the Board of the Harbors Modernization Group.

C: ATDC Board of Directors