



# IMANAKA KUDO & FUJIMOTO

---

## HAWAII CONDO FAX

A Faxletter on Condominium Development Issues in Hawaii

---

Mitchell A. Imanaka, Editor  
Owen T. Iida, Co-Editor

Volume 7, Number 2 ❖ April 2005

One of the hottest trends in the real estate market is the conversion of existing hotels into condominium hotels, or condotels. On the surface, condotels operate like normal hotels. Like a condominium, however, the rooms, or units, are sold to individual purchasers. A creation of a condotel can yield economic benefits to the developer and provide a sound real estate opportunity for purchasers.

### The Argument for Conversion

Recent trends have shown that older and poorly-located hotels have not generated good room rates and not provided their owners with good returns on investment. This is partially attributable to a change in consumer tastes, with consumers willing to pay more for beachfront hotel rooms and shying away from off-beach hotels. Instead of selling a low-yielding hotel to a hotel investor, the same hotel can be converted into a condominium and sold as individual units.

Purchasing condotel units can be a great opportunity for a small investor who cannot afford to buy a hotel or second home. Prices for a furnished hotel room are generally less than a unit in a residential condominium, which provide parking and a full kitchen. Condotel units have also proven popular among airline employees who make frequent visits, frequent vacationers and parents seeking dorm rooms for their children. The unit owners have the option of staying in their units or renting the room out to guests. They are also afforded the option of managing the room themselves, turning it over to a seller-designated on-site manager, or hiring an off-site manager. Other benefits to the purchaser of a condotel unit include:

1. Staying in a hotel instead of a residential condominium, with all the amenities a hotel has to offer.
2. The possibility their unit will appreciate in value.
3. The possible deduction of mortgage interest, real estate taxes and other expenses such as utilities and depreciation.
4. The collection of rental income to help defray costs.

### Legal Issues for the Developer

While the units themselves are not securities, they do become securities if they are offered or sold in such a manner as to create an "investment contract". A developer must take special care to make sure that the sale of condotel units does not constitute an offering of securities, which would require registration with the Securities and Exchange Commission and state securities law administrators. The developer of a condotel must be wary of the following that could require securities registration of the project:

1. The sale of condotel units coupled with certain other arrangements, such as a rental arrangement.

2. Any sales program suggesting potential economic benefits that the purchaser might derive from the ownership of the condotel or its occupancy by hotel guests.

3. Any arrangement that provides for an exclusive rental agent or otherwise materially restricts the purchaser in the occupancy or rental of his or her unit.

Because of these securities concerns, it is especially important that a condotel developer educate its sales and marketing personnel about what can and can't be said to prospective purchasers. The sales and marketing staff should especially be wary of the following:

1. The sale cannot emphasize the economic benefits derived from the purchase.
2. There can be no participation in rental pools.
3. Purchasers cannot be materially restricted in the occupancy of their units.
4. Purchasers must have the right to terminate any rental agreement on reasonable notice.
5. Written descriptions of rental programs may only be given to prospective purchasers who specifically request such materials and the marketing materials should not include any projections or emphasize economic benefits.
6. Any written material regarding the rental history of comparable facilities provided to the prospective purchaser must contain only publicly available information (raw data without further analysis).
7. No rental or management contracts can be entered into before the unit is purchased.

While there are complexities involved in the conversion of hotels into condotels, in most cases, careful planning can help avoid the pitfalls and allow you to reap the benefits of this growing trend.

*E kuahui like I ka hana*

*Let everybody pitch in and work together*

---

This Faxletter is provided without charge as a service to the clients and friends of Imanaka Kudo & Fujimoto. It is intended for informational purposes only and does not purport to offer legal advice as to any specific issue.

Copyright 2005 Imanaka Kudo & Fujimoto  
All rights reserved.

---

**We hope that you have found this faxletter informative. However, if you prefer not to receive future issues, please check the box below, write your name/company name legibly, and fax it back to us.**

