

# LEGAL NOTES

## FROM THE DESK OF HAROLD CHU

It has been almost a decade since we were advised that the condominium statute would be revised. The new condominium statute became effective July 1, 2006. In this newsletter, we will discuss some of the more noticeable changes which affect owners of condominiums.

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You often hear about FICO and how it affects one's cost of borrowing. We will attempt to demystify FICO and explain how it is important to you. We will also suggest what you can do to improve your FICO score.

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We are nearing the busy holiday season. If there are any transactions or matters you wish to complete before 2007, we suggest that you do so at this time. Honolulu traditionally slows down towards the end of the year and it is sometimes difficult to get things done. We suggest that you not wait to complete any transactions that you want done in 2006.

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## SOME RECENT CHANGES IN THE CONDOMINIUM STATUTES

**A**fter many years, the condominium statutes have finally been recodified. The law became effective July 1, 2006. In this article, we discuss some of the changes which may have the most noticeable impact for those of you who own condominiums.

### Upkeep of High Risk Components

Hawaii Revised Statutes § 514B-138. Upkeep of condominium; high-risk components. If the unit owner fails to follow requirements imposed by the board, the association, after reasonable notice, may enter the unit to perform the requirements with regard to high-risk components, such as dryer vents and wax toilet seals, at the sole cost and expense of the unit owner. While some owners may resent the association's entry into their units, the reason for such authority is to possibly prevent some of the more common damages in condominiums complexes.

### New Insurance Requirement

The new statute imposes required insurance limits which may cause an increase in your maintenance fees. Hawaii Revised Statutes § 514B-143(a)(2) now

requires associations to have commercial general liability insurance against claims and liabilities arising in connection with the ownership, existence, use, or management of the property in a minimum amount of \$1,000,000, or a greater amount, if the board deems it necessary.

### The Association May Collect Rent from the Delinquent Owner's Tenant

Hawaii Revised Statutes § 514B-145 allows the association to collect the rent from the tenant if the owner is more than 30 days in default of paying the maintenance fees. The board, for as long as the owner is in default, may demand and collect from the tenant or the rental agent, an amount sufficient to pay all sums due from the owner. The association may also collect interest.

### The Association Can Evict Your Tenant

The association can, but is not required, to take action against your tenant. Hawaii Revised Statutes § 514B-104(b) provides the association greater

*(See CONDOMINIUM STATUTES, Page 3)*

## What's a FICO and How Does it Affect You?

In the credit world, you often hear references to "FICO". What is "FICO" and how does it affect you?

FICO is a mathematical model created by the Experian Credit Bureau as a tool for lenders to evaluate the risk associated with lending you money. People with better FICO score are considered to be less likely to default. Those people are preferred borrowers and get better terms.

Your FICO score is calculated by looking at parts of your credit report and your debt to income ratio. Various factors in your situation are evaluated. Each factor is assessed and assigned points. The points are then added to get your FICO score. Some of the factors which are considered are:

- 1) how long you have been at your current address, your job or profession;
- 6) the amount of time you have had established credit.



- 2) your debt to income ratio;
- 3) the number of late payments;
- 4) the amount of credit you have outstanding;
- 5) the amount of credit you are using; and

Typically, a score below 650 characters you as someone with a high default risk. A score higher than 650 is better, but you are still in the "questionable" category. You may have to provide further documentation to get loan approval. A high score like 700 and above is considered a good score and you will likely be able to get the best rates and terms for your loan.

Your FICO score is important. Higher FICO score will qualify you for better interest rates, higher credit limits, and more types of credit.

## How to Improve Your FICO Score

Now that you understand what a FICO score is and how it may affect your credit or the loan you get, what can you do if you want to improve your score? The following are some suggestions:

### 1. Pay your bills on time.

This is probably the single most important thing you can do to improve your FICO score. If you have had delinquencies or judgments, you can still improve your score. Past delinquencies and credit mistakes count less over time. Tax liens, child support liens, civil judgments and small claims judgments come off your credit report after seven years. Late payments, accounts turned over to a collection agency, and accounts written off as a loss are removed after seven years. The time when bankruptcies are removed from your report depends upon the type of bankruptcy.

**2. Maintain low credit card balances.** If you have high outstanding balances on your credit cards, the amount of your debt can pull down your score. As a general rule, your account balances should be below

75% of your available credit. Paying down the debt will improve your score because it will reduce your debt to available credit ratio.

**3. Check your credit report for accuracy.** As we have advised you in past newsletters, you are now entitled to a free credit report each year. We suggest that you try [www.annualcreditreport.com](http://www.annualcreditreport.com) to get your credit report from any of the three major credit bureaus. We advise you to get a free credit report each year. Consider it a financial check up. If there is an error in your credit report, it is important that you contact the original creditor to correct your report. You should also contact all three credit bureaus so that the inaccurate information is cleared from all your credit reports.

**4. Pay off debts rather than moving the debt around.** Moving your debt around by charging it on other credit cards or spreading your debts on multiple credit cards will not improve your FICO score. You simply need to pay down the amount of debts that you owe to improve your score.

**5. Manage your credit cards responsibly.** Credit cards do not lower your score. The key factor is whether you have managed your credit card debts responsibly. Over the long term, having a few credit cards, carrying low balances and paying them on time will benefit your score more than not having any credit cards at all.

**6. Don't open multiple accounts too quickly.** This is especially true if you have a short credit history. This may reduce your FICO score because it is perceived that you may be taking on a lot of debts. New cards also reduce the average age of your existing accounts which could also lower your FICO score.

**7. Don't close an account to remove it from your record.** This will increase your debt to available credit ratio and lower your credit score. Your average length or average age of credit history also may decrease. Closing an account still shows up on your credit report. Closing an account does not help unless

(See HOW TO IMPROVE, Page 3)

## SHOULD YOU CONSIDER AN EXCHANGE FOR YOUR INVESTMENT PROPERTY?

For those of you who own and wish to sell their investment real property, there is good news and bad news. When we speak of investment property, we are talking about real property other than your personal residence. The good news is that with the recent real estate market in Hawaii, your investment property has probably increased substantially in value. The bad news is that if you sell your investment property, you may have to pay capital gains tax on your substantial gain.

While you cannot avoid the tax, you can **defer** paying the tax by using a 1031 exchange. A 1031 exchange allows you to swap one property for another. In a 1031 exchange, no gain or loss is recognized on the exchange of properties held for productive use or trade. A 1031 exchange allows you to **defer** paying the capital gains tax as long as your investment remains intact in the form

of "like kind" real estate. A 1031 exchange is named after that Section of the Internal Revenue Code, which permits the exchange. The proceeds of the sale is reinvested in property of "like kind". There are a number of properties that qualify for a "like kind" including other rental property, raw land, business property, commercial property, condominiums and apartments.

How does a 1031 exchange work? In a 1031 exchange, you do not receive the proceeds from the sale of your investment property. The proceeds are received by an intermediary, who purchases for you the "like kind" replacement property that you designate.

It is important that you fully satisfy the provisions of a 1031 exchange, because if you fail to satisfy all the provisions, you could nullify the 1031 exchange and be required to pay the capital gains taxes on your

original transfer. For example, the tax payer must within 45 days of the close of the initial sale identify in writing the intended replacement property and the purchase of that replacement property must be completed within 180 days of the initial sale.

It is important that the 1031 exchange be planned in advance. For example, there should be a provision in your sales contract which provides that your buyer will cooperate with the 1031 exchange. Some of the escrow companies in Honolulu have departments that will facilitate and help you with your 1031 exchange. Our discussion here is a simple explanation of 1031 exchange. A 1031 exchange is not overly complicated, but you do need to pay attention to the details. As with all tax related matters, we encourage you to consult with your tax advisors.

### HOW TO IMPROVE

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you pay down your debt at the same time.

**8. Shop for a loan within a concentrated time period.** Inquiries made within a concentrated time period will be perceived as a search for a new loan and not as an effort to establish new credit lines. You want to avoid too many inquiries over a lengthier period of time because these inquiries may be interpreted as a sign you are seeking credit because you are overextended or are having financial difficulty.

**9. Avoid unnecessary credit card accounts.** More credit cards are not considered a positive when your FICO score is computed.

**10. Seek credit counseling if needed.** If you are having difficulties managing your credit on your own, you may wish to see a credit counselor to assist you in improving your credit.

### CONDOMINIUM STATUTES

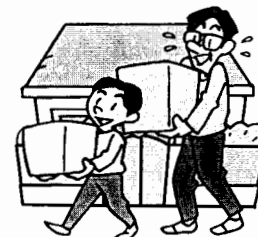
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powers against an owner's tenant. If a tenant of a unit owner violates the declaration, by-laws, or rules and regulations of the association, in addition to exercising any of its powers against the unit owner, the association **may**:

(1) Impose charges, penalties, late fees and interests, assessments and fines against the tenant;

(2) After giving notice to the tenant and the unit owner and an opportunity to be heard, levy reasonable fines against the tenant for the violation, provided that a unit owner shall be responsible for the conduct of the owner's tenant and for any fines levied against the tenant or any legal fees incurred in enforcing the declaration, bylaws or rules and regulations of the association against the tenant; and

(3) Enforce any other rights against the tenant for the violation which the unit owner as landlord could lawfully have exercised under the lease, **including eviction**, or which the association could lawfully have exercised directly against the unit owner, or tenant.



The owner should expect the costs, such as the legal fees, will be assessed to the owner. Thus, it is in the owner's best interests to directly manage and handle their tenant problems.

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HUMOR

An attorney was on his death-bed in the hospital. When a friend came to visit, he found the lawyer frantically leafing through the Bible. "What are you doing?" the visitor asked. The sick lawyer replied, "Looking for loopholes."



A teacher, a petty thief and a lawyer all died and went to the Pearly Gates. Because of crowding, St. Peter told them they had to pass a test before ascending any further. Addressing the teacher, he asked, "What was the name of the famous ship that hit an iceberg and sank?"

"The Titanic," she answered, and St. Peter motioned her into heaven.

The thief was next. "How many people died on that ship?" St. Peter asked.

"Gee, that's tough," the man replied. "But luckily I just saw the movie. The answer is 1500." St. Peter let him through.

Then St. Peter turned to the lawyer. "Name them."

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