

Regional Outlook

Island Life

Honolulu Benefits From Strong Condo Demand and a Weak Dollar

By *Ricky Cassidy*



What a difference a few years makes. Two years ago, Hawaiians, like many Americans, worried about deflation, war in the Middle East, and SARS in Asia. Two years from now, will the 50th state be working off the excesses of a real estate bubble? That remains to be seen. For now, though, it's condo-mania as the sales pace and prices of condos rise.



In Honolulu, which relies on tourism and military spending, condo sales are breaking records for the second year in a row.

Photo: Larry Brownstein/Getty Images

Looking ahead, the Honolulu multifamily market boasts strong demand, low supply, and an economy that is underwriting future growth.

But what sets this market apart from other U.S. cities is Hawaii's close ties with international economies, particularly those of southeast Asian countries. Ironically, the shaky American economy has given a two-fold boost to Hawaii's own economy: The devaluation of the dollar abroad makes it cheaper for foreign tourists to travel here, and

domestic tourists choose Hawaii over a bad exchange rate in a foreign land. By all accounts, Hawaii is the place to be.

Local Forecast

"Firing on all cylinders"—that's how economists such as Carl Bonham of the University of Hawaii have described the Honolulu and Hawaii economies. Construction is booming, hotel room rates and occupancies are climbing, and military spending is robust. Indeed, for the last four months, Hawaii's seasonally adjusted jobless rate was the lowest in the country (2.9 percent in Hawaii versus 5.8 percent nationwide).

Military spending is an important factor in the Honolulu market, accounting for about 15 percent of the area's GNP. With a number of sophisticated weapons systems and logistical platforms being placed at Pearl Harbor and Hickam Air Force base, there is a big push to expand the military infrastructure, particularly housing (\$10 billion over 10-plus years) to accommodate service personnel and their families.

While future economic growth

is predicated on federal—and mainly military—spending, a strong visitor industry is currently fueling the economic fire. Tourism, which dropped in the past two years due to SARS and the Iraqi conflict, recently rebounded, thanks to the return of Asian travelers and more visitors from the West Coast. Most recently, due to hurricane damage in the Caribbean and Florida, the East Coast also has sent a number of visitors to Hawaii as well.

Of course, job growth and rising incomes are key to housing demand, and those are on the uptick as well. The level of real personal income in Hawaii is expected to grow by 2.8 percent in 2004 and 3.6 percent next year. The number of jobs is also projected to increase by roughly 2 percent for each of the next two years, with most of the gains in the professional and business services sector, followed by health care and other services.

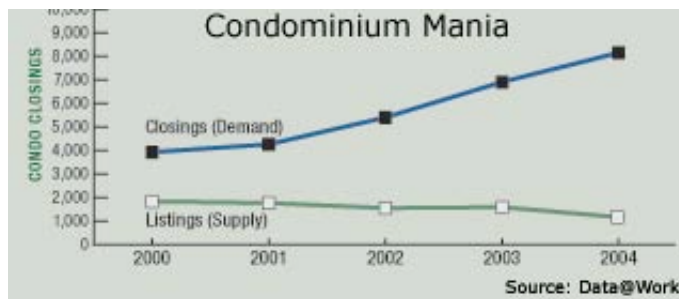
Rental Reality

But those trends have not translated into rent growth. Nationally, Honolulu is ranked by the US Census as the fourth-highest priced home market, but it is one of the lowest-ranked rental markets.

Historically, Honolulu's multifamily rentals have been weighted heavily towards short-term renters and have been dominated by mom-and-pop operators. Of late, the market has been whipsawed by shrinking supply coupled with shrinking, then growing, demand.

Demand has been dampened during the low-interest-rate environment that began in the mid-1990s, as renters became homeowners. Indeed, the rental vacancy rate went fluctuated from 8 percent in 2001 to 5.5 percent in 2002 before returning to 7 percent last year. This flux may be due to a market filled with tired, old units. "Most of Honolulu's apartment buildings were built in the '60s and '70s, with very little spent on improvements since," says Steve Heimler, whose company, Stratus Real Estate Inc. of Woodland Hills, Calif., has picked up 1,000 units in the last year.

Driven by economic growth and shrinking supply, rental levels have been rising by double digits the last three years. Large- and small-scale apartment owners and investors have been selling now that prices have finally increased. Some sellers are cashing out, and others are switching into to-be built units in the new high-rises, expecting good overall returns (including price appreciation). Demand from visitors and would-be second-home owners is also pushing pricing: More and more short-term tourists are turning into



As demand for condos has risen in Honolulu, supply has fallen (above). In response, condos have become more costly in Honolulu (below), thanks to classic economics.



longer-term visitors, choosing to stay in condos rather than hotels—or becoming full-time residents themselves.

Soaring Sales

The numbers back up such anecdotes and observations. For the second straight year, condo closings in Honolulu will set an all-time record. For 2004, the market should expand by 17 percent to 8,900 units closed, up nearly 200 percent from 1997, when the market began its rise.



Relative to mainland markets, Honolulu is only now getting its pricing growth spurt. The price index for all multifamily units (resale and newly built) in Honolulu moved higher the last two years by double-digit percentages but almost always suffered shrinking prices in the eight years before that. But price levels are forecasted to grow 22 percent for 2004, with new multifamily homes selling for a median of \$340,000 per unit. The newly built market segment is pulling prices upward the hardest and will continue, as catering to the higher end in Hawaii is resulting in

good margins and absorption.

It is reasonable to expect prices to continue rising, given that they have not been doing so in any significant way for about 10 years. At some point, though, the acceleration of pricing values will dampen the velocity of the market.

Besides cascading demand, Honolulu's price hikes arise from low supply: Builders haven't kept pace. Indeed, the developer community was decimated during the recession of the mid-1990s, especially the high-rise market, with three of the largest companies dissolving or decamping from the state.

Revival came in 2002, with a 247-unit luxury high-rise by Bert Kobayashi and Duncan MacNaughton, with sales prices averaging \$1.1 million per unit. This was quickly followed by a 100-unit high-rise in Waikiki by Alexander & Baldwin, a development company based in Honolulu. This project also promptly sold out thanks to investors and residents. Currently, there are at least seven high-rise towers in the works, thanks to arrival of several offshore developers and financing institutions.

"The high end of the market has been addressed," says Kobayashi, whose current project with the Kobayashi Group in Honolulu is Capital Place, a 350-unit condominium at the entrance to downtown Honolulu. "We now need to serve the needs of the much larger middle-income group."

Stan Kuriyama, CEO of Alexander & Baldwin's real estate division, who also is planning projects adjacent to downtown, agrees. "We believe the future demand for well-located, in-town high-rise product will remain strong, driven by a revitalization of the urban core and worsening traffic conditions in the suburbs," he says.

Rising prices have precipitated a steady stream of conversion deals, like so many places elsewhere in the country. These conversions were mainly subsidized housing, old hotels, or condo projects under leasehold ownership. Most were converted into owner-occupant units, but some stayed as rentals due to the covenants governing them.

Sunny Skies

Going forward, while for-sale multifamily developers are considering rental projects, current projected revenues have not quite yet lined up with land and other costs. The two projects being planned have mixed-use elements: Stanford Carr Development in Honolulu is doing a mixed use shopping center development with a large number of subsidized rental units in West Honolulu, and General Growth, a national development firm in Chicago, is converting a shopping area into a retail/parking/apartment structure in its Ward Center retail district in Honolulu.

Said Stanford Carr, the company's CEO: "While building costs are a concern, we think we see a way to take some of the burden off families searching for affordable rental units."

For the near-term, it is a seller's market, with a low supply of listings leading to strong upward pressure on prices. But landowners, developers, builders, and, finally, landlords are benefiting too, as the demand for rental housing outstrips supply by an increasing margin.

In the end, that gap could be closed by rents that rise faster than sales prices—or prices that tumble. But with an ailing US dollar, low real estate values relative to other states and countries, and a growing emphasis on national security and military spending, all of which support the Hawaiian economy, it is hard to imagine values falling in Honolulu anytime soon.

—*Ricky Cassidy* (cassidayp003@hawaii.rr.com) is owner/operator of *Data@Work*, a residential real estate market analysis firm in Honolulu.

[|Back to Top|](#)

[|Back to Home Page|](#)

[Site Map](#)