CHAPTER 22

HIGH RENTS

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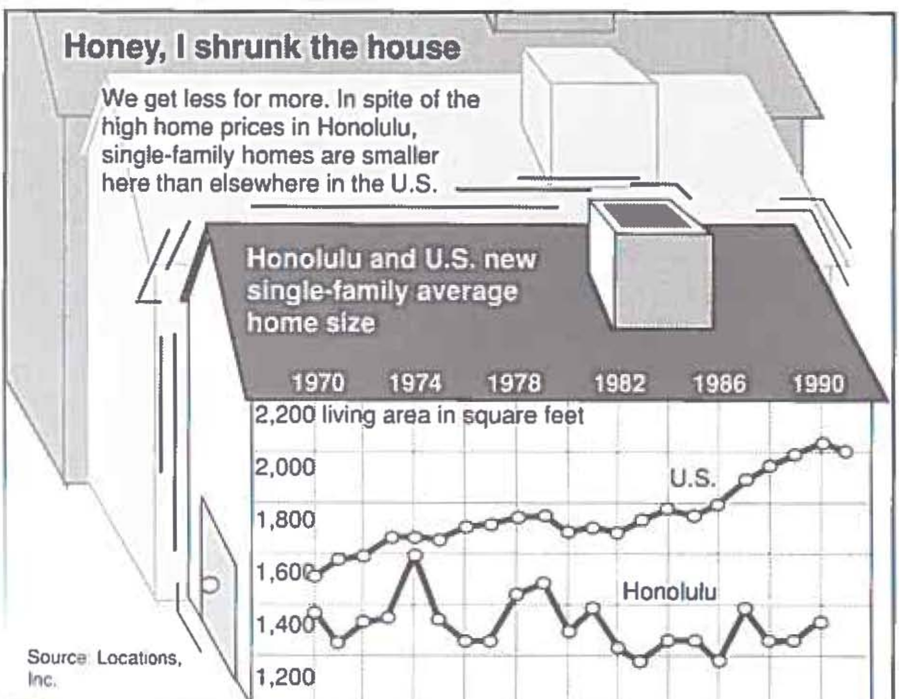
"Are rents in Hawaii high because of greedy landlords? Would rent control legislation help?"

Residential rents in Hawaii are high, when compared to the Mainland. The magnitude of the difference is shocking. This has been true for a long time and will be true for the foreseeable future. "Greedy landlords" occasionally have been blamed, and rent controls proposed but the answer lies elsewhere.

From the perspective of rental property owners, rents in Hawaii are **low**! Think about it. A mainland investor usually can set rent at a level that will provide more than enough cash flow to cover debt service and operating expenses. Typically, mainland rents for a full year will be 8 to 10 percent of a property's value. In Hawaii, rents seldom are high enough to cover a new owner's cash flow needs, and usually amount to no more than 5 percent or so of the property's current value. Does that sound like "gouging"? Besides, if rents are so high, why don't "greedy landlords" build more rental properties in order to take even greater advantage of these "high rents"?

People (and entities) who own property in Hawaii are neither more nor less greedy than those in places where housing costs are low. With exceptions too rare to matter, property owners everywhere will sell or rent housing for the largest amount possible. It may be a sad commentary on human nature, but self-interest is the engine that powers our free-market economy.

Not enough housing. The high cost of housing can be traced to one disarmingly simple fact: for many years the supply of housing has lagged behind the demand. One result is that owners of existing rental housing units have enjoyed a "tight" market. For example, normal vacancy rates on the Mainland are about 1.5 percent for single-family homes and 6 to 7 percent for apartments. The vacancy rates in Hawaii have been less than a third of those, despite high rents! Plus, we cram ourselves into less space. Here in Hawaii, it is not uncommon for extended families to share housing. Even people who can afford to buy a newly constructed home generally have to make do with less space than would be acceptable elsewhere.



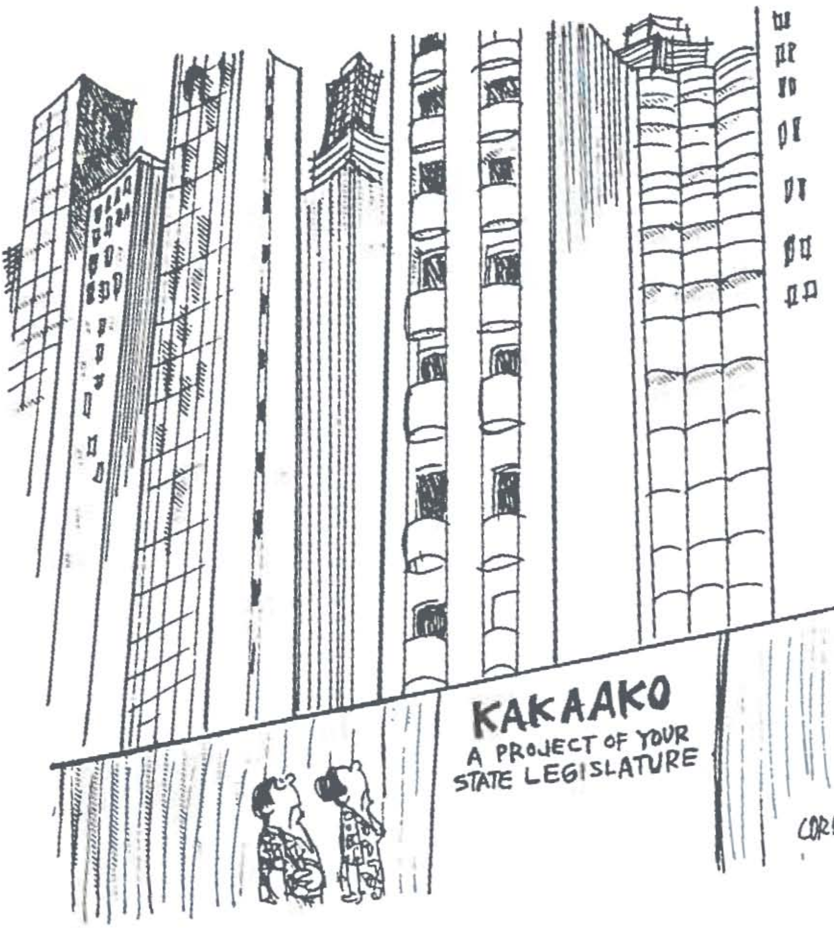
The shortage of housing is not a deep, dark secret. You know it; I know it; government knows it. Our elected officials talk about this and try to give the impression that much is being done to correct the problem. You undoubtedly are interested in results. With that in mind, let's first take a peek at the bottom line. Oahu's housing inventory grew by 77,296 units during the 1970s, but by only 30,615 units during the 1980s. If every single-family unit currently (early 1992) planned for the 1990s actually gets built—and that's a big "if"—it will do no more than equal new demand. It will not even begin to eliminate what I estimate to be a current deficit of 15,000 housing units.

Government talks much about its success in providing "affordable housing." For the most part, these efforts have been focused on making home ownership possible for a very select group of people too poor to buy single-family homes at market prices and too rich to qualify for traditional forms of government assistance. Renters, however, probably realize that someone else's opportunity to buy a house for less than its market value (rather than at market value) does not address their problem of high rent.

Affordable rental housing has had to play second fiddle. Between 1982 and 1984, the Hawaii Housing Authority developed 373 housing units under the federal low-rent public-housing program. The number of new units dropped to 48 between 1985 and 1990, an average of less than ten per year. Is it any wonder that the waiting lists for public housing grew longer each year and homelessness increased? To be fair, the State's affordable housing initiatives involved a few low-rent projects, and officials are talking in 1992 about doing more. This is good, and should be encouraged, but in terms of numbers it may be too little, too late.

Government's direct involvement. We have in Hawaii a unique situation where state and county governments actually have gone into the housing development business, competing with the private developers they regulate. (This is as unfair to these developers as it would be for you to take your basketball team to the NCAA finals only to find the referee is the coach of the other team!) It's no surprise that many developers decided to shelve their plans.

The reason government housing agencies can build when private developers cannot is that only they have the advantages of insignificant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land costs, the ability to borrow at municipal-bond interest rates, a virtual "free pass" in the lengthy regulatory process, and the luxury of not being required by shareholders to earn a profit.

Government, however, is not solely to blame for Hawaii's housing shortage. It is the work of an unlikely coalition of interests. This includes not only bureaucrats and elected officials who enjoy the perks of power, but also environmentalists who see development as destructive, anti-growth advocates who point out that reasonable housing costs will bring more people to Hawaii, and property owners who want their homes and investments at least to hold their values, and ideally to appreciate substantially.

Housing costs won't come down as long as this coalition successfully chokes off new development. Trust me, if the market were left alone (read that, if this cabal got out of the way), developers would trip over one another to take advantage of the strong demand for housing in Hawaii.

Rent control. Several public officials have suggested that rent control would be a great way to deal with high rents. The mechanics of rent control are simple: the government establishes and then maintains prices prevailing on a given date (say, as of today) on rental units. The intended beneficiaries are low-income families who are least able to afford rising rental prices of housing.

What are the results of rent control? Nothing at first. However, with the passage of time and as tenants' incomes rise, those living in controlled housing find they have more money to spend on nonhousing items. So far, so good.

However, the story continues and from here on out it is not a pleasant one. The housing shortage worsens as investors put their money elsewhere. And, despite laws intended to prevent it, controlled units often go to those who can best afford them. Potential tenants may be asked to pay extra ("key money") for the right to lease a place, and persons low on apartment waiting lists move up suddenly with appropriate payments to apartment managers. Families unable to pay such amounts increasingly are forced to crowd together because no new housing gets built.

Controlled housing often is allowed to deteriorate. The government can mandate minimum maintenance standards and even allow repair costs to be shifted to renters, but there is little incentive for landlords and it is hard to police. Los Angeles designed its rent control provisions with this problem in mind. But a 1991 study concluded that a counterproductive trade-off was unavoidable: "Efforts to reduce the costs of rent control, namely the deterioration and removal of dwellings from the rental stock, will generally be accomplished only by reducing the benefits received by tenants."

Another concern is that rent control can reduce the mobility of families. Moving from a controlled apartment generally requires that another be found, usually at an expense of time and money. This impacts most on the poor.

No easy answers. Don't get me wrong. The related problems of housing shortages and high rents are complex, and numerous judgment calls have to be made along the way. For example, if we do significantly increase the supply and get housing costs down, expect lots of newcomers. That may not seem so bad when unemployment is low, but it certainly will when unemployment is not so low.

If the cost of housing stays down and jobs stay plentiful, expect more traffic, more pollution and a noticeable reduction in the quality of life. Oh yes, and for all you homeowners and investors out there, don't be surprised if the inflation-adjusted value of your property falls.