CHAPTER 24

AFFORDABLE HOUSING REQUIREMENT

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"Has Hawaii's affordable housing requirement been effective?"

For a lucky few, Hawaii's bold and innovative "affordable-housing" requirement has provided much-needed affordable homes. But the primary effect has been to *increase* housing prices and, as a result, to make most of the rich richer and most of the poor poorer. Furthermore, the requirement has decreased the availability of affordable homes in older neighborhoods and contributed to economic and social problems. Overall, the requirement has been a multibillion-dollar misjudgment.

Causes of high housing prices. Since before statehood, Oahu's housing prices have been among the highest in the nation. Major factors which have contributed to high housing prices are: (1) the *strong demand for housing* resulting from a rapidly expanding economy driven primarily by the visitor industry; (2) the *finite supply of developable land* on a relatively small island having a mountainous interior; (3) *federal, state, and county* use of a large amount of developable land (for instance, military installations); (4) *restrictive government policies* designed to protect agricultural lands and environmentally sensitive areas, but which also restrict the supply of developable land (policies which have been partially relaxed in favor of developing homes on agricultural land in Ewa and in portions of Central Oahu); (5) the *very difficult, slow, and expensive approval process* which impedes the supply of land for housing, limits entry of new developers, and reduces competition among landowners and developers; (6) *insufficient construction of roads, water, sewers and other infrastructure* which further restricts the supply of developable land; (7) *high development fees* imposed on developers by government to cover the cost of infrastructure; (8) *high construction costs* due to shipping costs, high-markups necessitated by low volumes, high wages for construction workers, and other factors; and (9) *Japanese buyers* who, for a short period ending in 1990, added to the demand for luxury housing in a few East Honolulu neighborhoods.

An additional factor often cited as a cause of high housing prices is that the *ownership of land is dominated by a small number of owners* who can restrict the supply of developable land and thereby charge high prices for the land. Actually, however, major landowners have been willing to develop far more land than government has been willing to allow.

In spite of the presence of most of these conditions during the early 1980s, inflation-adjusted prices of single-family homes actually dropped from 1979 to 1986. Housing was becoming more affordable!

Affordable-housing requirement. In early 1988, when most major developers on Oahu were running out of land approved for residential development, the State—without public dialogue, legislative debate, or any analysis ever made public—imposed its new "60-percent-affordable-housing" requirement on major new subdivisions. The policy was hailed as a bold and innovative solution to Hawaii's housing crisis.

In justifying the requirement after the fact, the State argued that (1) the private housing market does not work properly since, without the requirement, developers build luxury homes rather than needed affordable housing (while new single-family homes in major subdivisions were indeed expensive prior to the affordable-housing requirement, most were typical tract homes priced about 20-percent **below** used single-family homes); (2) by granting approvals, government enables landowners and developers to realize enormous "windfall" profits, so it is fair for government to share in this windfall (in the form of the affordable-housing requirement which supposedly provides public benefits); (3) the loss of prime agricultural lands to housing requires that the public receive considerable benefits (i.e., affordable housing) in return; and (4) the allowed price of affordable housing is set so high that this is not a significant burden on developers.

On the surface, these justifications appear to have merit, and the affordable-housing requirement seems to offer a solution to Hawaii's high housing costs. Unfortunately, however, the affordable-housing requirement has contributed to housing becoming *less* affordable.

Restricted housing supply and higher prices. Before proceeding with a costly housing project, a developer must be satisfied that the project eventually will yield a reasonable profit. But under the 60-percent affordable-housing requirement, only 40 percent of the homes in the project—that is, the "market-priced" homes—must carry the burden of providing most or all of the profit. Consequently, some projects which would be profitable if all of the homes could be sold at market prices become unprofitable and are not initiated when only 40 percent can be sold at market prices. This is particularly true for projects having high development costs due to such factors as hillside locations, large development fees for interchanges, and high land and carrying costs.

The affordable-housing requirement has in fact affected development. In 1988, a major developer of typical tract homes calculated that a project would not be profitable under the affordable-housing requirement until prices of single-family homes increased by at least $20,000. Two other developers postponed indefinitely their submittals of subdivision applications because the requirement made their projects unprofitable. Yet another developer had problems securing financing for a project due to low profits caused by the requirement. Also, the number of subdivision applications submitted to the State decreased sharply in the early 1990s. Even government housing projects at that time encountered difficulties in meeting the requirement. Prices of their affordable units had to be increased because sales of "market" units would not generate the profits necessary to make the projects economically viable.

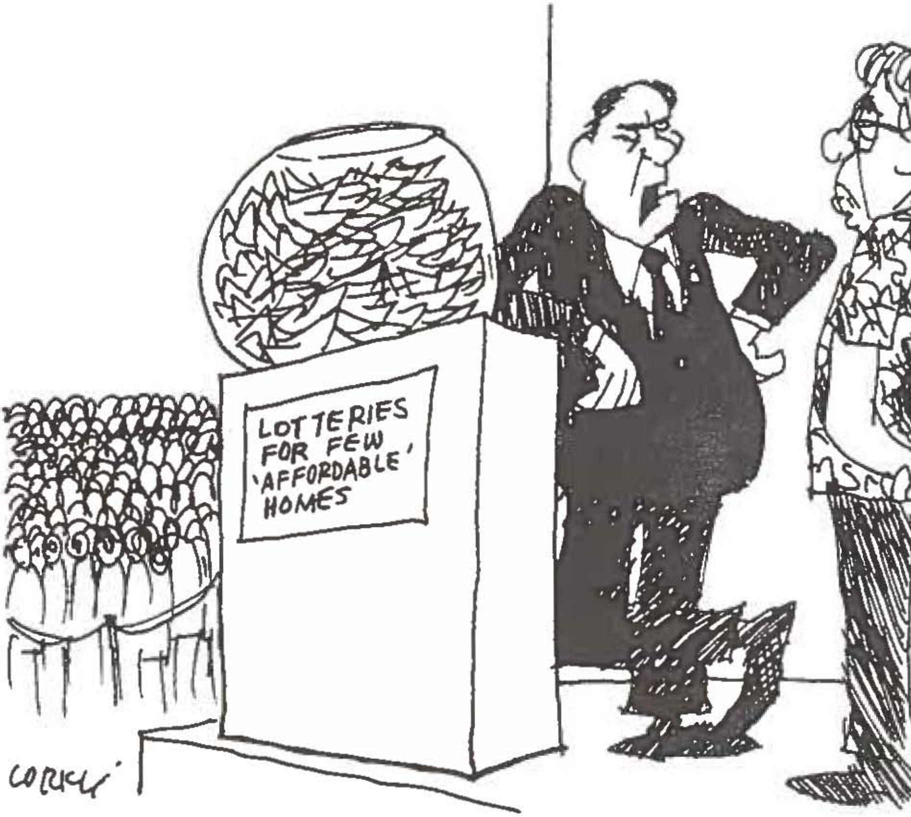
Because the affordable-housing requirement results in less housing being built, the supply of new housing is constrained. In turn, housing prices rise until demand is choked off sufficiently to bring demand in balance with the restricted supply. To varying degrees, the higher prices pervade the entire housing market, including rental and for-sale single-family homes, townhouses and condominiums. Of particular significance, the higher prices pervade the very large supply of *used* homes.

So what did happen after the affordable-housing requirement was implemented? Oahu's housing prices rose 90 percent in the three-year period ending in 1990, far surpassing price increases in major cities on the Mainland, including cities which experienced faster employment and population growth rates. Granted, additional factors were involved, including inadequate housing construction in the early 1980s due to extremely high interest rates, a lack of land approved for development, a strong demand for housing in the late 1980s due to the growth in the visitor and construction industries, higher development fees for infrastructure, and Japanese purchases of luxury homes in East Honolulu. Nevertheless, the affordable-housing requirement contributed to the rapid escalation in housing prices.

By 1992, it was generally recognized that the affordable-housing requirement was slowing the construction of new homes. In an effort to correct this situation, the State modified the requirement to allow developers greater flexibility in meeting it. However, the fundamental causes of high housing prices remained, including the negative effects of the modified affordable-housing requirement.

Economic and social effects. The affordable-housing requirement and the resulting increase in housing prices and rents has generated enormous impacts. A lucky few low- and moderate-income families have won housing lotteries (or were among the first in line) to buy homes at "affordable" prices which were significantly below-market prices. In effect, the wealth of these families increased.

Unfortunately, most low- and many moderate-income families have been hurt financially by the requirement. The renters and first-



"A STATE LOTTERY ABETS GAMBLING, GIVES PEOPLE FALSE HOPES, IS DEMEANING AND HARMFUL TO THE COMMUNITY..."

time home buyers who did not qualify for a housing lottery, or did not win one, have had to pay significantly more for their housing for the reasons discussed above.

Paradoxically, the primary beneficiaries of the affordable-housing requirement have been families who owned homes and rental property in 1987, before the requirement was imposed. Their wealth was increased substantially by the rise in housing prices which occurred in the late 1980s. The increase in wealth attributable to the affordable-housing requirement exceeded $2.4 billion for Oahu homeowners. (This estimate is based on approximately 120,000 single-family homes on Oahu in 1987, times the $20,000 increase in value discussed above for 1988, and excludes the increase in value of the larger number of condominiums.)

In effect, the affordable-housing requirement has made most of the rich richer and, except for a few lucky families, it has made most of the poor poorer.

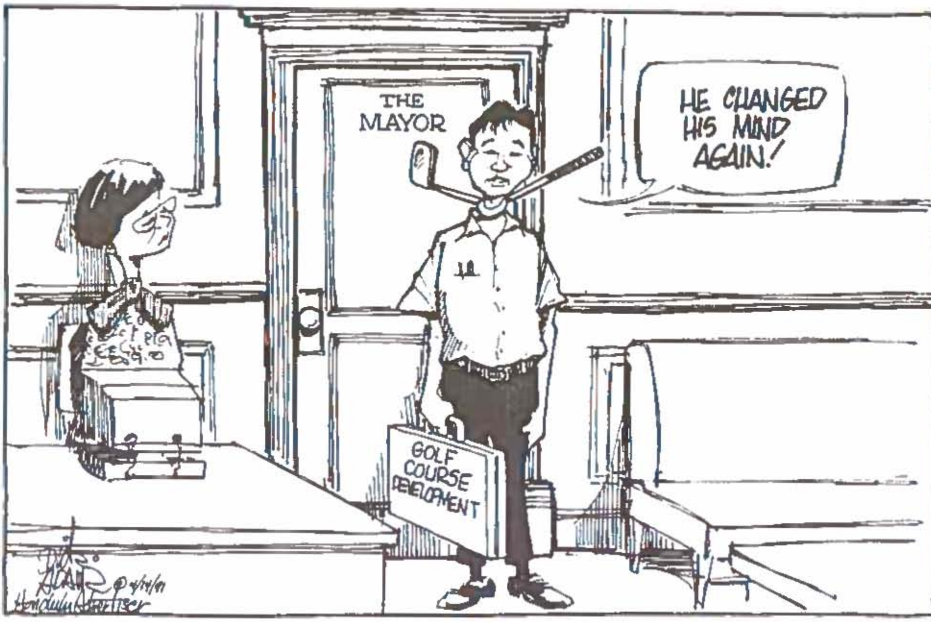
The affordable-housing requirement and the resulting rise in housing prices has also reduced the supply of less-expensive homes in older neighborhoods by generating strong economic incentives to replace these perfectly livable homes with upscale homes. This is accomplished by renovating and enlarging older homes, or demolishing them to clear land for new, upscale homes. The developer thereby avoids the affordable-housing requirement as well as the infrastructure development fees required for new subdivisions. In the process, Oahu's supply of older less-expensive single-family homes in established neighborhoods diminishes.

The higher housing costs add to our economic and social problems. Renters and first-time home buyers who do not win a housing lottery have a lower standard of living; crowding is increased; many young people who cannot afford housing leave the islands; recruitment of teachers, professors, physicians and other professionals becomes difficult; attracting new businesses is inhibited, etc.

Solutions to high housing prices. The affordable-housing requirement demonstrates that, however well-intentioned, government intervention to dictate what should be produced and at what price can make a problem worse rather than better.

For homes to be priced within reach of moderate-income home buyers and renters, it must be recognized that Hawaii is not exempt from the economic laws of supply and demand and the benefits of competition. This implies that government should attack aggressively the major causes of high housing prices listed above which slow development of new housing and inhibit competition among landowners and developers.

Although a larger supply of new homes and more competition among developers will allow future housing prices to be lower than would be the case under current policies, high housing prices will remain a problem for lower-income families. Well-focused programs to supplement incomes and provide other assistance to these families will still be required.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