Affordable Housing
PUBLIC POLICY ISSUES AND OPTIONS

The SOCIAL SCIENCES PUBLIC POLICY CENTER, College of Social Sciences, University of Hawai‘i at Mānoa, is committed to enhancing the quality of community life in Hawai‘i, the United States, and the Asia Pacific Region, by educating professionals for careers in public life, conducting non-partisan policy research, and promoting civic engagement on issues of local, national, and international significance.
Affordable Housing

Public Policy Issues and Options

College of Social Sciences
Public Policy Center
University of Hawaii at Manoa
Saunders Hall Room 712
808-956-4237

Susan M. Chandler, Interim Director
Introduction

The Social Sciences Public Policy Center presents below a brief report on the status of Hawaii’s economy and its impact on housing demand. Over the last few years, the state is seeing a significant increase in the price of land and housing. These positive economic trends are also coupled with a decrease in the supply of affordable housing and rental units. While there is insufficient data to verify the precise locations of these trends, past housing booms—in particular the 1988-1992 boom—created affordability problems for low income and middle income households, and there is no reason to believe that this housing boom will be markedly different.

The Public Policy Center agreed to examine the economic trends that could be fueling this new housing market; collect, review and summarize existing studies and reports on housing policies and submit some recommendations for further study.

Economic Trends in Hawaii: Strong Growth Expected in 2004 and 2005

Three recent (November/December 2003) reports on Hawaii’s economy—from the Bank of Hawaii, the University of Hawaii Economic Research Organization (UHERO), and the State of Hawaii’s Department of Business, Economic Development and Tourism (DBEDT)—all reached the same conclusion: Hawaii had unexpectedly strong economic growth in 2002 and 2003 and should experience continued strong growth through calendar years 2004 and 2005. UHERO and DBEDT both report that real (inflation-adjusted) personal income in Hawaii increased by 3.9% in 2002 and by an estimated 3.5% in 2003. DBEDT forecasts real personal income growth in 2004 of 3.4% and in 2005 of 2.9%.

The strong expected growth comes on the heels of a broad expansion punctuated by the disruptive shocks of war and threats of new diseases. After making solid progress in 1999, 2000, and the first 8 months of 2001, Hawaii’s economy entered into a 20-month period of volatility after the 9-11 attack. With the sharp decline in tourism from Japan during Spring 2003—due to fears of SARS and terrorism during the Iraq War, there were serious concerns about the resilience of the Hawaiian economy. Yet during the last six months of 2003, a number of factors combined to spark strong economic growth in Hawaii.

- **Tourism from the U.S. Mainland.** A strong resurgence in mainland visitors from their post-9-11 lows helped Hawaii’s tourism industry stage a recovery from the triple shocks of 9-11, the Iraq War, and SARS.
- **Low Interest Rates.** The persistence of low short-term and long-term interest rates has been the spark behind growth in construction, finance, and real estate-related services in Hawaii.
- **Revivals in U.S., California, and Japan Economies.** The Japanese economy exhibited its first robust signs of growth since 1996-1997, the California economy
began a recovery from the depth of its recession, and the U.S. economy continued to recover from the mild 2001 recession.

- **Strong Military and Homeland Security Spending.** Additional federal spending on homeland security and the military was buttressed by additional capital spending devoted to military housing and facilities.

What are the main reasons behind the expected strong growth in Hawaii’s economy for 2004 and 2005? The main reasons for the robust growth forecasts are that the same elements which drove strong growth in 2003—better performance in the relatively weak California and Japan economies, strong performance in the U.S. economy, low interest rates, and increased military and homeland security spending—will bolster tourism and other sectors in 2004 and 2005. A very large expected increase in Japanese visitor arrivals—forecasts range between 16% and 24%—should be an important source of growth in 2004. The rebound in tourism is expected to be bolstered by growth in the local construction industry, services, and the federal and state governments.

UHERO estimates that the robust construction spending observed in 2002 and 2003 will be followed by a 17% increase in 2004. Based on the massive increases in construction permitting and the large military construction program, it finds that construction spending is likely to increase throughout the year and that the construction cycle peak will not be observed until 2005 or beyond. This means that the construction sector is also likely to continue to be a strong contributor to growth in 2005.

Overall job growth in Hawaii is expected to be relatively strong in the short and medium run, with UHERO and DBEDT estimating growth of 2.2% in payroll jobs in 2003, 2% in 2004, and 1.7% in 2005. Growth in the number of construction workers is helping to keep these rates high. UHERO estimates that the number of construction workers increased by 7% in 2003 and will increase by 5% in 2004 for a total increase of 3,000 workers.

As always, the “open” Hawaii economy—an economy dependent on exports of tourism and inflows of military spending—is vulnerable to negative shocks and could be stimulated by positive shocks. Possible negative shocks could include a slowdown in Japan’s economic recovery, further terrorism incidents, and a re-emergence of SARS. Possible positive shocks include a stronger than expected recovery in California’s economy, relocation of a battle carrier group to Hawaii, and persistence of low long-term interests—a boon to Hawaii’s construction sector.

**The Impact on Housing: Rapid Increase in Housing Demand**

Recent economic growth and the robust forecasts for growth have already increased the demand for housing. Due to the economic downturn in the 1990s, purchases of houses and condominiums in the State were generally flat, but over the last several years they have soared to record levels. Housing prices have regained the nominal levels of the early 1990s, but adjusted for the effects of inflation are still about 20% to 25% below
their peak real levels. There are numerous factors behind this rapid increase in housing demand. They include:

- **Persistent Increases in Real Personal Income.** Real personal income for Hawaii has risen every year since 1998. This is remarkable given the large declines in tourism in Fall 2001 and Spring 2003.

- **Demographic Factors.** There is a “pent-up” demand among individuals and families who already own homes or condominiums and now, with more income and low mortgage rates, will enter the housing market looking for larger homes, newer homes, second homes and/or condominiums. With more money to spend, and a positive economic forecast, there is likely to be increased demand.

- **Low Interest Rates.** Thirdly, declining mortgage interest rates have fueled the housing market across the nation for the last few years. Record numbers of families have re-financed their mortgages and this, coupled with six years of real personal growth increases in Hawaii, provides families with more money to invest and spend.

- **Positive In-Migration.** Honolulu’s population declined during the 1990s and population growth on Kauai, Maui, and the Island of Hawaii slowed. This was primarily due to the economic malaise of the 1990s. While international migration continued to push up Hawaii’s population during the 1990s, an outflow of Hawaii residents led to stagnation in growth of the overall population. Recently, there have been indications of in-migration of high-income, older residents from the U.S. mainland coming to Hawaii to reside part-time or year-round. Some of this increase may be due to poor job market conditions on the U.S. West Coast; an inflow of construction workers typically occurs during economic booms. However, many of the newcomers are wealthy “dot.comers” looking for second homes and/or retirement homes.

How has the recent economic and housing boom affected Hawaii’s citizens? In general, the effects of the economic boom have been very positive for the middle and upper middle classes.

- **Increase in Wealth for Homeowners.** Homeowners from all income groups are seeing the price of their homes increase and the interest rates on their mortgages decrease. The result is a large increase in the wealth of existing homeowners.

- **Rise in Percentage of Homeowners.** The housing boom of the late 1980s—a boom fueled by soaring tourism arrivals and Japanese foreign investment—decreased the affordability of housing in Hawaii and led to a smaller percentage of households owning homes. Only 50.2% of households owned their home in 1995 and 1997. The percentage of residents owning homes recovered after 1997, as homes became more affordable due to decreases in mortgage interest rates and in the price of condominiums and single-family homes. Another important
reason for the increase in the rate of homeownership was the volume of new housing construction assisted by the state and county governments. The two major projects were the county sponsored development in West Loch and the state sponsored development in Kapolei. The percentage of households owning homes continues to rise, with 57.4% of households owning homes in 2002—the highest rate observed in Hawaii over the last two decades. Recent increases in the homeownership rate have been fueled by rising personal incomes and lower interest rates. Rising housing prices have been a drag on this indicator, and possible increases in mortgage interest rates could, at some horizon also be problematic.

- **Relatively Low Affordability Gaps.** In the early 1990s the gap between what the median income household was able to pay for the median priced house was over $3,000 per month. By the end of the decade, the gap has shrunk to a little over $500. Over the last few years it has begun to rise again, increasing to over $700 in 2002. While the gap shows the difficulty the average Honolulu family faces in establishing a stable life in Hawaii, it is nonetheless markedly lower than the gap observed during the last housing crisis. We note, however, that prices of housing on the neighbor islands have increased more than on Oahu in recent years, a factor which may presage larger increases in the affordability gap on neighbor islands.

The run-up in housing prices has, however, not been positive for all groups. Some negative effects include:

- Reduced short-term vacancy rates for rental housing.
- Higher rents for many low-income and middle-income residents who do not own their housing.
- Increased difficulties in finding Section 8 housing.
- Increased numbers of elderly and persons with disabilities wanting and needing community-based, special needs housing.

While time did not permit more extensive data gathering and analyses relating to the effects of Hawaii's economic growth, the above effects have typically presented in the past from similar increases in housing prices and rents and can be anticipated here. Many of the newcomers to the states—international migrants and temporary construction workers—will be looking for rental housing and are likely to place more pressure on rents as the flow of these workers continue and housing stocks increase by only small amounts initially.

**Government's Role in Hawaii's Housing Markets**

The Hawaii State government has been an active participant in mitigating the effects of a housing price run-up. In fact, government (federal, state and local) programs are already in place which can help to offset the impact of the housing boom on low and moderate income Hawaii residents. Since the last housing bubble of the late 1980s and the early
1990s, government has also greatly improved the implementation of these programs to mitigate the impacts of future housing booms on low-income residents. The major federal, state, and county housing programs currently in place are presented below.

**Federal Programs**

**Low-Rent Public Housing.** The low-rent public housing program provides housing units for households earning less than 50% of median income. The units are "owned and operated" by the Housing and Community Development Corporation of Hawaii (HCDC). Residents pay 30% of their incomes per month for rent. The federal government through its Department of Housing and Urban Development (HUD) provides annual rental and capital improvements subsidies. HCDC manages approximately 5,400 housing units.

**Section 8 Rental Subsidies.** The Section 8 program provides rent subsidies to households renting privately owned units. Household income is limited to 50% of the median income upon entry. A household pays 30% of its income for rent with the remaining rent subsidized by the Section 8 program. Each county and the HCDC administer their own Section 8 program. To limit the maximum rents allowable, HUD establishes fair market rents that landlords may charge. These limits, however, may be increased with HUD's approval. Particularly, in a tight, high rent market, these rental adjustments are extremely critical if low-income households are to remain in and to locate rental units. Currently, over 12,000 Hawaii households receive Section 8 subsidies.

**Low Income Housing Tax Credits (LIHTC).** The LIHTC program is currently the major financing tool for private and nonprofit organizations to construct or rehabilitate affordable rental units. Under this program, federal and state tax credits are awarded by the HCDC to the development organization. These tax credits are usually sold to investors. Funds from the sale of the tax credits are used by the development organization to subsidize the cost of the rental units. Federal law requires that a percentage of the units be rented to households earning less than 60% of median income. The HCDC has generally required that all units be rented to households earning less than 60% of median income with priority to households earning less than 50% of median income. Since 1988, HCDC has allocated $350 million in tax credits to provide over 4,200 affordable rental units.

**Community Development Block Grant (CDBG) and Housing Investment Partnerships (HOME).** The CDBG and HOME programs have been the primary source of housing development funds for the counties. Hundred of millions of dollars have been programmed to the counties. On Oahu, the CDBG and HOME programs have funded many of the homeless, spouse abuse, mentally and physically challenged, and drug treatment facilities. Figures on the numbers of units available for low and moderate income families were not available or could not be obtained.

**Military Housing Privatization Initiative (MHPI).** The MHPI program was created in 1996 as part of the National Defense Authorization Act to address the poor condition of
military-owned housing, and a shortage of affordable private housing of adequate quality. In Hawaii, between 15,000 to 18,000 military housing units will be replaced and privatized through the MHPI program. Initial occupancy is expected within five years and full occupancy within 14 years. The total number of housing units is expected to equal the current supply of military housing. Currently, over two-thirds of military housing requires major renovation or replacement. The impact of the MHPI program will effectively increase the supply of affordable rentals by extending the useful life of military housing to fifty years while improving the quality of military housing.

State Programs

Most of the State of Hawaii’s housing assistance programs are administered by the Housing and Community Development Corporation of Hawaii. Its Five Year Strategic Plan: 1999 – 2003 states that its mission is “to serve as a catalyst to provide Hawaii’s residents with affordable housing and shelter opportunities in a balanced and supportive environment.” It has five major goals:

- Increase and preserve rental housing opportunities for low-income households and special need groups in independent and supportive living environments.

- Revitalize existing rental projects while promoting healthy neighborhoods and strong communities.

- Assist persons in housing programs and facilities administered by HCDCH to achieve higher levels of economic independence.

- Increase homeownership opportunities.

- Improve the housing delivery system through cost-effective management of government programs and resources.

Below we outline the major programs administered by HCDCH.

Rental Housing Trust Fund (RHTF). The RHTF provides equity-gap low-interest loans to qualified owners and developers constructing affordable rental housing. Recent awards require that 10% of all units be provided to households earning less than 30% of median income, also, that priority be given to households earning less than 50% of median income for the remaining units. Currently, the combination of the RHTF and LIHTC programs has been the most effective mechanism for delivering affordable rental housing. To date, the RHTF has awarded over $54 million to assist in the development of approximately 2,300 units.

Hula Mae Single Family Program (Hula Mae). Through the issuance of tax-exempt revenue bonds, the Hula Mae program provides eligible first time homebuyers with mortgage loans at below-market interest rates. The Hula Mae program is particularly
helpful when market mortgage rates are high or rising. To date, approximately 10,000 households have benefited from the program.

State Owned Master Plan Communities. The State, through the HCDCH, controls lands on the islands of Oahu, Maui and Hawaii that have been set aside for master planned communities. Potentially, these master planned communities could provide thousands of housing units for market and affordable homebuyers.

Villages of Kapolei (VOK)

The VOK is master planned for 8 “villages” within 888 acres in West Oahu with a capacity of 4,500 single family and multi-family housing units. The VOK is approximately 60% built; thus there exists a capacity for 2,000 new housing units.

Villages of La’i‘opua (La‘iopua)

La‘i‘opua is located in north Kona and is master planned for 3,700 housing units on 807 acres. To date, approximately 500 housing units have been completed or planned for development leaving a capacity for 3200 new housing units.

Villages of Leiiali‘i (Leiali‘i)

Leiali‘i is located in Lahaina and is master planned for 4,800 housing units on 1,120 acres. No housing has been developed on this site, primarily because of “ceded land” issues.

Programs for the Homeless

The goal of the State’s homeless programs is to assist homeless persons gain skills to obtain permanent housing. The HCDCH accomplishes this through programs that provide a continuum of services to homeless persons. The continuum of care is a commitment to identifying and engaging homeless persons; directing them to the most appropriate housing and services; fostering individual responsibility; maximizing use of mainstream programs; developing and encouraging development of permanent housing; and reassessing and redirecting the continuum of care as demographics and need of the homeless change.

The HCDCH serves as a resource agency and liaison for private, county, state and federal agencies that work with the homeless. The HCDCH contracts with approximately 25 private service providers to deliver health, social services, emergency and transitional housing. The Hawaii State Legislature appropriates approximately $4.5 million annually for homeless programs benefiting 12,000 to 14,000 unduplicated homeless persons.

Recently, a consortium of private and public organizations—The Policy Academy—was established. The Policy Academy meets regularly to coordinate plans, strategies and programs to serve the homeless population. It is affiliated with a national network of other policy academies. The national efforts are intensely focused on solving the
problem of homelessness in ten years. HCDCH serves as the coordinating agency in Hawaii.

Special needs housing for the elderly and persons with disabilities desiring to live in the community is also an emerging problem throughout the state.

**County Programs**

In addition to administering the federal Section 8 Rental Assistance, CDBG and HOME programs, the counties have initiated important programs to provide affordable housing.

**Affordable Housing Requirements.** Landowners or developers requesting major land use amendments are subject to affordable housing requirements. After many decades of negotiations, each county now has existing or proposed rules requiring the provision of affordable housing. However, each county establishes its own requirements and implementation program. Implementation has been flexible depending on market conditions. For example, in the dormant real estate market of the middle 1990’s to early 2000’s, implementation was eased. Unit requirements were reduced or waived in face of slackening or nonexistent demand. The major requirements established by each county are presented below.

**Oahu**

30% of all units must be affordable; specifically 10% must be affordable to qualified buyers earning less than 80% of the county median income and the remaining 20% must be affordable to qualified buyers earning between 80-120% of the county median income.

**Hawaii**

10% of all units must be affordable to qualified buyers earning less than 140% of the county median income.

**Maui (No Adopted Rules):**
Administratively, Maui has imposed a 10% requirement for qualified buyers earning between 90-110% of the county median income.

**Kauai (Proposed Rules):**

30% of all units must be affordable; specifically requires that 4.5%, 7.5%, 9.0% and 9.0% be affordable to qualified buyers earning 50-80%, 80-100%, 100-120% and 120-140% of median income, respectively.

Whether or not affordable housing requirements have increased the supply of affordable housing in Hawaii is debatable. Affordable housing requirements are, essentially, a tax on the development of other housing projects. During boom times, developers are willing to pay this tax; however, as the boom ebbs, the affordable housing tax has the effect of
stopping the development of new homes more quickly. Turning the rules on and off at precise points in the housing cycle is problematic and can lead to problems in uniform application, predictability and reasonableness. Both county and state governments need to approach affordable housing requirements with caution. While such requirements can serve valid roles in particular housing development projects, they can also impede the overall housing market.

Exemptions for Affordable Housing Projects: 201G Projects.

Qualified affordable housing developments may be granted exemptions by the county from numerous county land use and zoning ordinances provided prescribed conditions are satisfied. For example, on Oahu, projects eligible to receive exemptions from development standards must provide that: 1) at least 50% of the units in the project are made available to low, moderate and gap group income households; and 2) contain at least 50 units. Projects qualifying for 201G exemptions may save years in the development process.

Government; Role in Mitigating Housing Problems: Suggested Recommendations

Government cannot abandon its role to facilitate the provision of housing, particularly, affordable housing. The needs are too great. However, with the threat of increasing financial risks and exposure and limited state and county budgets for housing, government must be more prudent and selective in its role.

In this period of limited resources, government could consider devoting limited housing funds to the most vulnerable of our residents - the homeless, disabled, poor, elderly. Residents of government-sponsored housing need to be provided with the social and economic support services with an ultimate goal of self-sufficiency and financial independence to break the culture of perpetual subsidy. Government should continue its role of facilitating private sector developments and minimizing direct competition in development of market units. Therefore, government’s private sector policies must be balanced to provide the private sector with sufficient incentives for developing affordable housing.

Precise policy recommendations cannot follow from this policy brief, as it does not examine government programs and their effectiveness in meeting the current and future housing demands of Hawai‘i’s residents. It is, however, vital to distinguish between the short run and long run housing policy. In the short run—two to three years—changes in government policies are unlikely to produce many new housing units. Government policies for the short-run must therefore focus on ways to run existing subsidy and shelter programs more efficiently and on increased funding for those merit-worthy programs which support our most vulnerable residents. It is recommended that the following approach might be considered:
Focus on the Most Disadvantaged. Focus on increasing funding for housing activities that benefit the most vulnerable individuals and households by assisting development of affordable rental and special needs housing, including housing for homeless, disabled, and elderly persons.

Increase Section 8 Fair Market Rents. Increase the fair market rents for the Section 8 Rental Assistance Program to a level that will permit applicants to qualify for "reasonable" vacant units. Many landlords will not rent to Section 8 applicants. Other possible options might be more problematic, eg. the Legislature could ban discrimination of applicants in Section 8 housing impose penalties on landlords refusing to take Section 8 applicants.

In the long-run, government should focus on how it can cut regulatory red tape impinging on private provision of housing, open new government lands for housing (if desired by the electorate), and reconsider its double veto (i.e., reviews at the county and state levels) on housing developments. Such measures—see below—will help to increase the supply of housing and lower housing prices. Recommended actions for government to provide long-run foundations for a healthy housing market include the following:

Streamline Programs Focused on Financing Rental Housing. Assist and facilitate private sector developments through streamlining permit processing and expanding sales and rental financing programs such as the HULA MAE, the Rental Housing Trust Fund and LIHTC programs.

Opening State-Controlled Land for Housing. Request housing development proposals from the private sector for state controlled lands in Kapolei, Lahaina and North Kona. Resolve ceded land issues which may preclude development.

Government Coordination. Increase and improve coordination of planning and funding of affordable housing among the various government agencies at both the state and county levels.

The Hawaii State Government already has many of the necessary programs in place to address a new housing crisis. However, providing additional funding for programs identified as particularly effective would be a critical step in avoiding a housing crisis. Funding alone, however, is not enough. It will take bold steps to examine policies and programs, phasing out those which have not or do not work and implementing successful programs more effectively.

Over the last two decades, state and county governments have learned that they are not immune to development risk and financial exposure and must manage its resources more effectively and efficiently. Realizing the need for cooperation and mutual assistance to achieve their respective goals, the public and private sectors must work collaboratively to develop a full range of housing, affordable and market. Government has become and should continue to be adaptive to dynamic social and economic conditions so it can
respond with more timely and appropriate housing programs and policies. Developing collaborative partnerships at the federal, state, county levels and with the private and community sectors are critical to effective planning and implementation of housing to meet the changing and growing demands of Hawaii’s residents, particularly those who have incomes at the low or moderate levels and those most vulnerable with special needs.
APPENDIX
Figure x

Real Private Building Permits
(1982-84$ Thou.)

--- Real Private Building Permits (1982-84$ Thou.)
Growth in Hawaii Real Personal Income (Percent)

Yr-Yr % Chg
Single Family Housing Resales - Maui

Condominium Resales - O'ahu
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