



HAWAIIAN BUSINESS COMPASS

by Yamaguchi & Yamaguchi, Inc.

Yamaguchi &
Yamaguchi, Inc.

Real Estate
Appraisers &
Consultants

Since 1967

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THE HAWAII REAL ESTATE CYCLE: BOOM THEN BUST?

Where are we in the current real estate cycle? The buyers are back and the economy appears to be improving. Will this cycle be similar to others or is this one different? We both have been through three major real estate cycles covering four decades and see similarities and differences in our Hawaii real estate cycle.

During each real estate cycle there were three types of buyers that directly affected the marketplace: the Owner Occupant, the Investor and the Speculator. The actions of these three types of buyers continue to affect real estate cycles. Also, to better understand our current market we need to look at our demographics and socio-economic factors that affect the market today and into the future.

The Owner Occupant Buyer is in the market to purchase a shelter and will likely sell and move up to a larger home and/or a more convenient location. This type of buyer stabilizes the marketplace which leads from a gentle-to-moderate cycle of increases and decreases of sales prices. About 80 million Echo Boomers born between 1982 and 1995 are now young adults and are affecting the economy much like their Baby Boomer parents had done in the past. However, unlike their parents who had the American Dream of being a suburbanite with the coined phrase “having a home surrounded by a white picket fence”, the Echo Boomers are trending toward a more urban lifestyle. Many are willing to trade size for location resulting in more demand for multi-family housing. Commute time to and from work and the lack of quality family time has also contributed to increase demand.

The Investor Buyer has investment capital to maintain a reasonable cash-flow. This type of investor usually expects to hold the property from 2 to 5 years and then sell for a reasonable profit.

The capital market resurgence is back in vogue with real estate and money pouring back into the industry to finance new properties and refinancing existing ones. Underwriting requirements are becoming less stringent and loan to value (LTV's) are increasing.

U.S. investors are increasingly focusing on emerging markets i.e. China, Brazil and India and the debt in European Countries make investment attractive. Foreign investors find U.S. to be an attractive investment environment due to unique transparency and land tenure unmatched in other parts of the world.

The Speculator Buyer may not have the holding power but gambles on a quick resale or the popular broker term “flip”. When the speculator enters the market two things can happen: first, on an up market, they influence prices to rise astronomically and second, on a downturn they dump their properties at below previous market prices.

This type of buyer is potentially dangerous and damaging to the marketplace due to weak holding power. As we have seen in past boom markets, this buyer creates artificially inflated real estate prices and eventually negatively impacts the market by selling at de-

pressed prices.

There are numerous real estate statistics available to the general public today. The skilled analyst must be able to qualify, quantify and analyze the data accurately in order to avoid skewing market information. The following analysis portrays our realistic view of the marketplace today.

Historic Overview

Inasmuch as the Hawaiian real estate market has been, is, and will be characterized by tight supply and high demand, the critical components to successful development are: A. timing the delivery of the units to

occur within the period of market upswing when demand is being fed by buyer capability and confidence, B. putting it in a location that is equal or better than the comparable competition, and C. doing it at a cost that allows pricing to be equal or lower than the comparable competition.

The reason Hawaii's residential market enjoys such overwhelmingly strong demand is our very high quality of life, especially in comparison with other locations. This is our comparative advantage in housing, and is based on a unique combination of attributes, which include temperate climate, beautiful surroundings, accommodating society and culture, American jurisprudence and dollar-denominated economy.

The reason Hawaii's, and Oahu's, residential market suffers from tight supply is primarily due to geography: land is limited and isolated. This has in turn contributed to two other supply limitations: political NIMBY and cost of production. The body politic and its elected representatives have implemented a set of laws that serve to further limit supply of available land, via zoning regulations, and a very lengthy process of consulting with the public. On the cost side, there is high-cost labor and a long supply chain to deliver the necessary inputs for construction – plus the longer than normal time frame.

The combination of inelastic supply and elastic demand makes this market extremely volatile: over the swing between the bottom and the top of the market, sales can more than treble and prices can more than double. Furthermore, the length of the cycle is usually 5 to 8 years, depending often on external conditions: the direction



ALSO IN THIS ISSUE

5

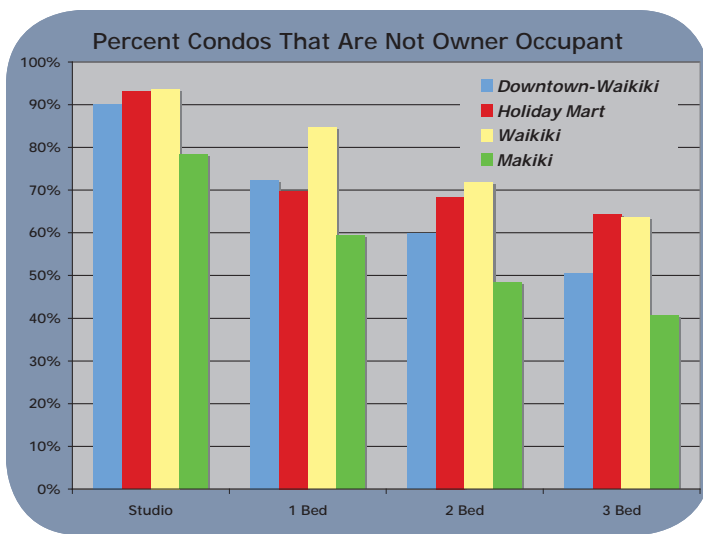
Simply... Stephanie ... Hawaii
Chief of Police Lee Donohue... “Cops & Kids”

THE HAWAII REAL ESTATE CYCLE: BOOM THEN BUST? *Continued from Page 1*

of interest rates, economic growth in the visitor and offshore buyer markets, and the costs of materials.

Demand

There are two components to residential housing demand: local residential housing demand (primary housing); and offshore demand (secondary housing, or second homes). In terms of condominium ownership, the offshore buyers are significant. For instance, around 70% of all Maui Condos are owned offshore. This is not the case for Oahu or Honolulu, where most owners live and work on the island, except for certain areas: Waikiki, Ala Moana and Kakaako, where offshore ownership can be upwards of 60% of total units. The chart below shows the percentage of condos that are not lived in by owners, meaning they are investor units. Of 100% of these investors, about 50% are non-residents of Hawaii.



Historically, this demand has been driven by economic growth and personal prosperity in the Pacific Rim countries. Indeed when there is an accumulation of wealth in these offshore markets, there is a coincident and concurrent rise in the sales and the prices of residential units in and around Waikiki and Kapiolani on Oahu, and the resorts on the neighbor islands. For example, demand in the last real estate cycle came from California residents who benefited from the growth of the technology, the real estate and the natural resource markets. The importance of the offshore market is shown in the chart above – very few units are ones in which their owners are the occupants.

Demand for residential units locally is driven by the visitor industry, in the first place, and then by government spending, which includes federal (defense), state and city government, plus local service spending and construction activities. Currently, both these stimulants of economic activity and housing demand are on the upswing: tourism is near an all-time high and military spending in the Pacific remains on an upward trajectory, thanks to instability in East Asia and relocation out

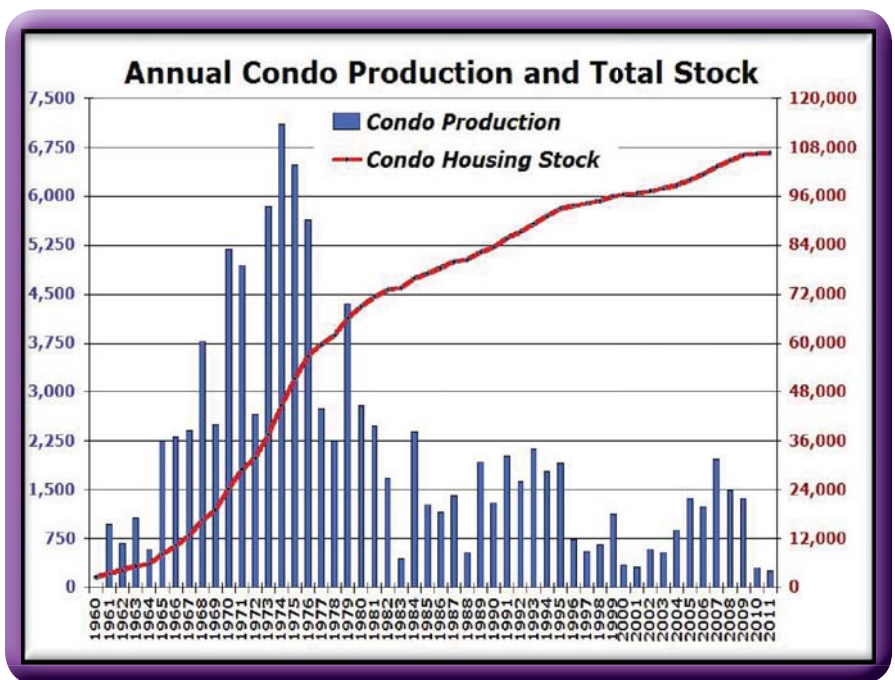
of Japan of military personnel.

In terms of the real estate market cycle, we currently are at the bottom, the low point, in terms of the average for sales prices. Additionally, we are 1 to 2 years off of the bottom of the market in terms of sales of condominium units on Oahu. We expect that the number of condominium sales will rise in each of the coming 3 years, and the average prices will rise over the coming 4 years (assuming no disruption of current economic trends). This would be consistent with the historical trend over the past real estate market cycles. In sum, we foresee strong demand for condominium units in Honolulu, and particularly from Waikiki to Kapiolani-Kakaako.

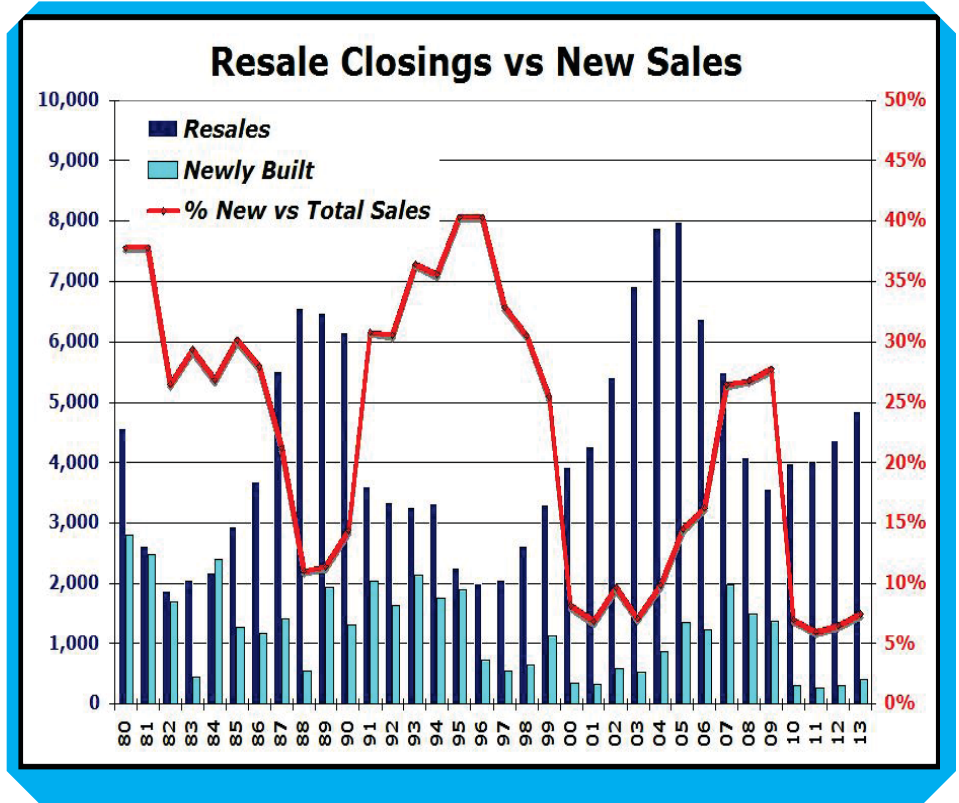
Supply

In the last two market cycle upswings, housing production on Oahu has been far below what it was historically, post-statehood in 1959. This is particularly true of the last one, 2000-2009. And, tellingly, large numbers of those units were ones targeted on offshore demand, to wit: Trump, Ko Olina Beach Villas, Watermark, Allure, Koolani, Hokua, Lanikea, 909 Kapiolani, etc. In all, some 11,000 units were completed 2000 to 2013, 9,000 total excluding the aforementioned high-rise luxury towers. Over the same period, the population of Honolulu grew by 120,000. This equates to 13 people for every condo. For arguments sake, add in an equal amount of single-family homes built during this time frame, and that still equates to over 6 people living in each dwelling produced on the island. Obviously, just since this century started in 2000, the level of local housing production falls way behind the population growth.

On the supply side of the market, we see low builder capacity, due to the long recession that eroded developer capacity to build homes (which also depleted the ranks of construction labor), lasting for a while. As seen in the chart below, condo production has been declining since the 1970s, for reasons noted above. This is true both island-wide and urban core.



Thus, looking ahead, we think that, as usual the supply of new residential units will be slow to respond to current and future demand. This can be seen in the Resale Closings vs. New Sales chart at the right, where new sales cycle downward for 4-5 years every 11-13 years (per the red line, showing the percentage of new sales to the total housing sales, new and resales). Looking at the current cycle, we see developer share of total market has fallen off only for 3 years, 2009-2011. However, that falloff was particularly dramatic, with the ensuing market share for developers hitting a record low of near 6% at the bottom.

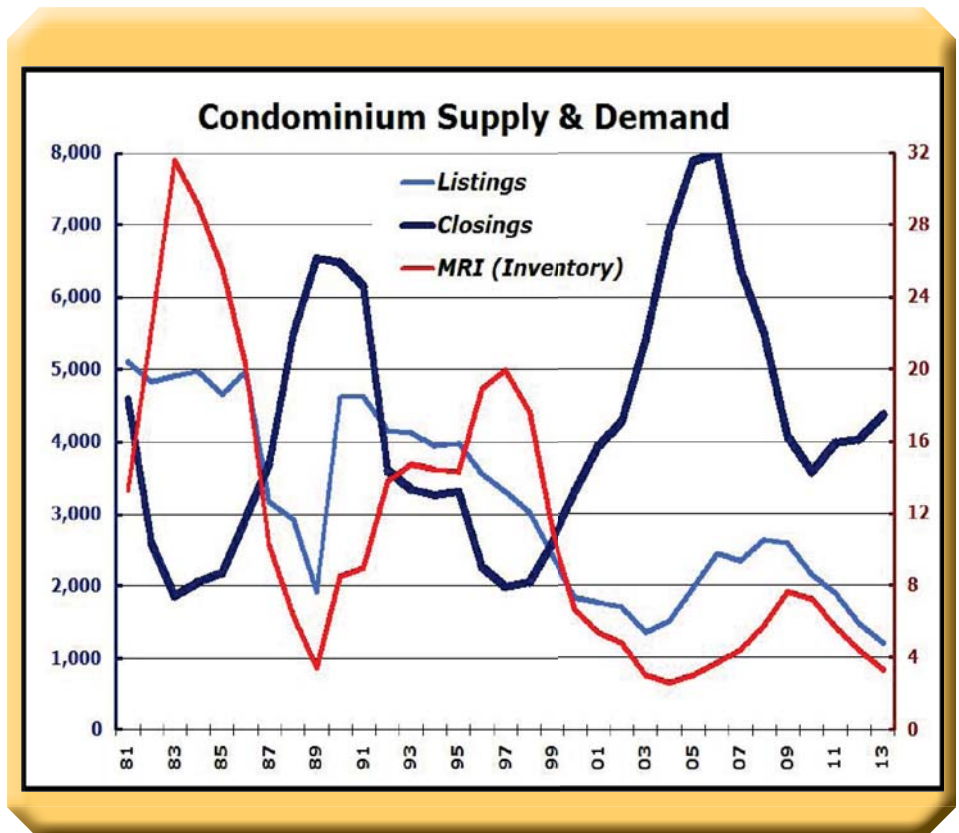


At the same time that the supply of newly built homes coming onto the market is at a low ebb, the level of resale listings on the market has also been shrinking, thanks to strong sales over the last 18 months. The chart (right) shows how the resurgence in demand housing has reduced the number of listings on the market (countercyclical), thanks to the recovery of the economy in the state and around the Pacific Basin. As this capacity to demand, housing has worked its way into the residential market on Oahu, the months of remaining inventory has declined in kind (MRI – the balance between the supply of listings that is available and the demand for housing from buyers entering and reentering the market).

As seen in the chart, a low MRI demonstrates that the balance of power in the market has shifted from buyers to sellers.

The other clear indication of this is that prices have been moving higher and higher, as sellers have experienced greater interest, as manifested by multiple offers. This has evolved to a situation where the seller maneuvered buyers to make higher and higher bids.

The question going forward is how long will the balance remain tipped in favor of sellers – will demand shrink in the face of higher prices, higher interest rates or



simple saturation. All possible to forecast, all hard to be assured one or the other will take place at a particular point in time. Ultimately, do your homework and utilize knowledgeable, seasoned professionals.

“Caveat Emptor” -- Let the Buyer Beware!

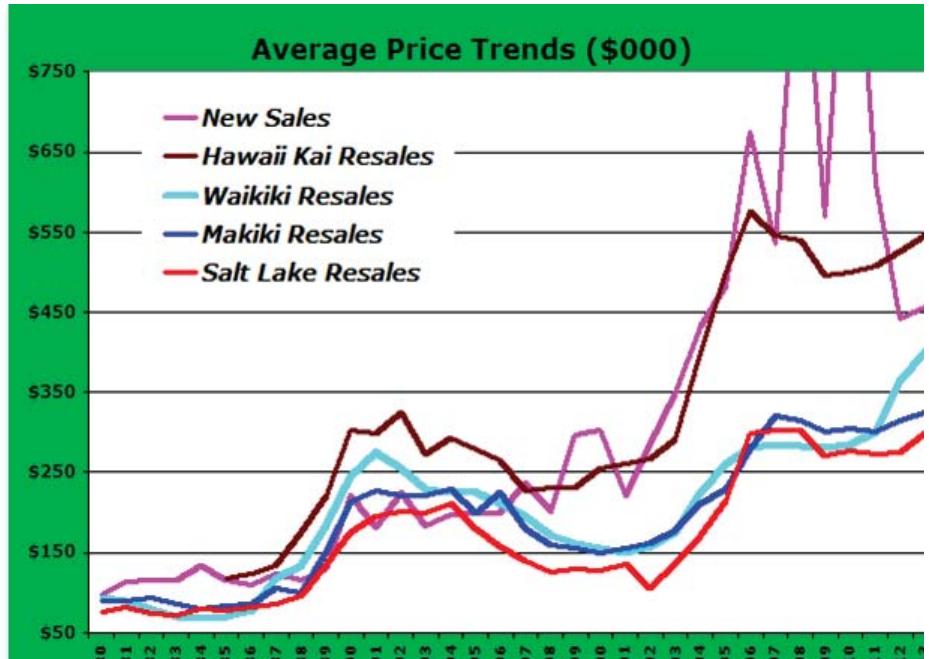
The Authors:

Ricky Cassiday of **Data@Work** has developed



the most functional database of real estate transactions for analyzing the residential market across the state of Hawaii. The data draws upon both public and private data sources and goes back to 1985, covering 2 major market cycles. It includes all islands and all resort and residential property

types, including leasehold. He has produced numerous types of studies (project feasibility, pricing programs, absorption projections, marketing strategy, product development, market entry and positioning) as well as long-term demand forecasts and models for specific markets and master planned developments. His work has helped to inform every major Hawaiian developer, financing institution, residential design firms, most landowners and construction companies. He has been a featured public speaker at the Hawaii Developer’s Council, the ULI Hawaii Chapter, the Society of Corporate Planners, Hawaii State Association of Counties, the Hawaii Association of Mortgage Brokers, the BIA Hawaii chapter, Association of Realtors for all the islands, numerous private groups, and the MBA Income Property, Investment Committee. He has been quoted in the Wall Street Journal, New York Times, San Francisco Chronicle, and Inman News.



Jon Yamaguchi CRE, FRICS, SRPA, SRA is the President of **Yamaguchi & Yamaguchi, Inc.**, a real



estate appraisal and consulting firm accomplished in both residential and commercial markets. Since 1967, Yamaguchi & Yamaguchi has serviced the real estate community throughout Hawaii and parts of the Pacific Rim including Asia. They have assisted their clients in decision making

relative to various needs, such as mortgage lending, investment decisions, collateral review, due diligence studies, lease negotiations and arbitration, condemnation, estate planning and date of death valuation.

A graduate of Iolani School and Colorado State University, Jon has been awarded the CRE designation from the Counselors of real Estate, Fellow (FRICS) of the Royal Institution of Chartered Surveyors, and the SRPA and SRA Real Estate Appraiser designations from the Appraisal Institute. He maintains a certified general license as a real estate appraiser and a real estate broker license in the State of Hawaii. He is the principal broker for REMM Pacific Realty LLC. Jon has also served in various positions and boards with the Counselors of Real Estate (CRE), Building Industry of Hawaii (BIA), Better Business Bureau (BBB), Honolulu Board of Realtors (HBR), Appraisal Institute (AI), Fannie Mae (FNMA), Vice Chair of the International Committee of the National Counselors of Real Estate Organization (CRE), Advisory Board for REMM International, Inc. and Principal of Y3 International LLC.

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Simply ...
Stephanie

Work Hard ♦ Play Hard

That's my philosophy of the balance in life; my yin yang, so to speak. In reality though, the fulcrum is rarely centered and the scale repeatedly slants away from play. So I have decided for my column to focus only on fun things . . .

Chief of Police Lee Donohue... "Cops & Kids"...

"The best thing about being the Chief of Police was being able to make an impact on programs, not only for police officers, but for the community... the work that I do in the community I call "Cops & Kids"..."

At the final review meeting for my article "Chef Alan Wong... Just a Regular Guy..." (Summer-Fall 2012), Chef Alan introduced me to Lee D. Donohue, Sr. and said, "Go interview him for your newsletter, he's a good guy, and a regular guy, too!" And just like that, I was interviewing Chief of Police Lee Donohue!

Chief Donohue has a calm demeanor and is a warm and engaging conversationalist. From humble beginnings, which he never forgets, this "regular guy" works tirelessly to give back to our community. Of the numerous foundations and organizations he is involved in, one that really touched Jon and me is Kick Start Karate, a Honolulu Police Activities League program he co-founded in 1994. It's not just about teaching and learning karate. The program continues its success in mentoring at-risk youths, teaching them traditional values, instilling character and encouraging them to pursue a higher education. [www.KickStartHawaii.org]



Little Known Facts

- ❖ I am ½ Korean and proud of that.
- ❖ My mom Agnes Pil Duk Lee was a widow with 4 children and had a little store on Hall Street in Honolulu (the street is not there now). My dad Elba Dixon Donohue had taken his discharge from the Navy here in Hawaii and was working as a civilian at Pearl Harbor when he met my mother at her store.
- ❖ Most kolohe (rascal) moments as a youth? Actually I was a shy kid. I was chased down once with my cousin when we were taking mountain apples from a tree located on private property outside the trail to Manoa Falls. Other than that, I was just a regular guy going to school, chasing girls, and working part-time as a Janitor at Oahu Plumbing & Sheetmetal. I used to love to repair cars and drag race when I was in my late teens.
- ❖ My proudest moment as a youth? When I graduated from McKinley High School and I know that my mother was so happy (maybe relieved) that I graduated from high school. She was always encouraging me to further my education. I still remember her smile that day.
- ❖ I coached football for 20 years: Pop Warner, Kaiser High School and Pearl City High School.
- ❖ I sit on 11 Non-profit Boards or Foundations: McKinley High School Foundation; St. Louis School Regents; Honolulu Police Community Foundation; Kick Start Karate; Crimestoppers; Visitors Aloha Society Hawaii (VASH); Honolulu Firefighter's Foundation; Pacific Air Force

Advisory Council; City & County of Honolulu Salary Commission; Judicial Council of the State of Hawaii Supreme Court and the National Institute of the Federal Bureau of Investigation

❖ Lucille's maiden name is Lucille Kyung Hee Park. We have been married for 52 years and will celebrate our 53rd Anniversary this September 24, 2013.

❖ We met in church. Luci and her twin sister attended the same church that I did. My cousin and I would sit behind them and

when we knelt on the pews, we would tickle their feet in front of us. I guess you could say I was rascal at times.

❖ Anything funny or special you can share about her? When a lizard appears in our house, everything stops! We have to catch the lizard without hurting it, take it outside and let it go. Then life resumes.

❖ Does Luci like to cook? Luci is a great cook when she gets into it. When we were young with our kids, she was able to do wonders with spam and corn beef.

Why did you become a police officer? I wanted to be a police officer when I was young. When the opportunity came, I took the test for the Los Angeles Police Department and the Honolulu Police Department and passed both. I then choose to stay home in Honolulu. (Donohue joined the HPD on July 1, 1964 and retired on June 30, 2004)

How did you become interested in karate? I was on the Honolulu Police Judo Team when my work out partner Bradley Kaanana was killed by the Pali Sniper. Two other officers were wounded, one of them being the Judo Team Captain. After that, the Judo team lost some momentum so I took up karate as I wanted to learn more and I was transferred to the Pearl City District where my best friend, John Gerard was teaching a karate class which I joined. (Donohue has earned an 8th degree black belt in karate)

What is your greatest personal achievement or accomplishment? The day I became the 8th Chief of Police of the Honolulu Police Department. (April 13, 1998)

What is your proudest moment as the Police Chief? When the Honolulu Police Department became the 13th Major City Police Department that was accredited in 2004. We put a lot of hard work to accomplish the accreditation of our Department during my tenure as Chief. There were 55 Major Cities in the United States at that time. Cities such as, Los Angeles, San Diego, San Francisco, Washington D.C. were not accredited. I was proud that we (the men and women of the Department) as a Department were able to accomplish this in 3 years. The Honolulu Police Department is still accredited today.

You use the term: "Cops & Kids" as what you do in the community; your brand, so to speak. Please explain. I guess we need to expound on the Honolulu Police Community Foundation that I co-founded and serve as its president. HPCF also provides scholarships for college bound students, buys equipment for HPD that could not be purchased through the normal budget process, and provides funding for medical alert devices for those in the community that live alone and are at risk of falling. I think this along with Kick Start brings clarity to the term Cops & Kids.

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*“ It’s the repetition of affirmations
that leads to belief. And once that
belief becomes a deep conviction,
things begin to happen. ”*

~~ Muhammad Ali

ABOUT HAWAIIAN BUSINESS COMPASS

Our Hawaiian Business Compass newsletter was created to provide our friends and clients with informational topics that could possibly benefit them in their business and personal lives.

We author and feature articles that pertain to:

- Real estate trends and valuation
- Business issues
- Positive motivational content
- Human interest stories, and
- Varying topics provided by guest writers

As relationships are very important to us, our HBC newsletter gives us an opportunity to keep in touch, share our information and create something that is interesting and fun.

Jon and Stephanie Yamaguchi

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