

JUNE 2004

**BUILDING**  
INDUSTRY

# How Far Can We Go? Hawaii's Developers Today — and Tomorrow

*By Lee Schaller*

*Things just seem to get better and better for Hawaii developers.*

*We reported in 2002 that optimism was way up and business was beginning to boom. Last year, 2003, was even stronger, with developers telling us that the "boom" was not just a sporadic, here and there occurrence, but seemed to be "a pattern extending throughout the state."*

*And then there is today. Just about everyone interviewed for this current report says 2004 is better than 2003 — and that was a very good year.*

*Does this mean that all the news is positive — no complaints, no concerns, no controversies? Not quite.*

*In recent months, there has been a stirring among some community groups on Oahu regarding "too much development" in their areas — a sentiment that has been a source of contention between developers and community activists on Maui and the Big Island for several years.*

*Is there room for more growth? What is the answer to the demands of a growing population and the desire to retain the unique essence of the islands?*

*How far can we go?*



Richard Dunn, executive vice president, sales and marketing for Haseko Realty, at Ocean Pointe

## **A Continuing Need**

"Apparently there is still a need for more homes on both Oahu and the neighbor islands," says Mary Flood, vice president, sales and marketing for Schuler Homes, a D.R. Horton Company. "All new home developers are having a hard time building fast enough to satisfy the market." Flood reports that this year Schuler will see an increase of roughly 25 percent, from approximately 400 to 500 homes. "Other developers will probably be having substantial increases as well," she says, "although deliveries may be less than projected due to the delays suffered as a result of the recent concrete strike. Maui and Hawaii have had a tremendous increase in new developments, from a couple hundred homes being built in 2003 to double that in 2004."

Richard Dunn, executive vice president, sales and marketing for Haseko Realty, agrees. "I think we can go further," he says. "There is a very limited supply of new housing on Oahu versus current demand. Hawaii has one of the lowest percentages of home ownerships in the U.S. With today's current interest rates, it has become much more affordable for the first time home buyer. Up until recently, many people could not sell their current residences at a profit. Home appreciation took quite a while to catch up here in Hawaii. The qualities and amenities of new housing are attracting people to move up into nicer, bigger homes -- something they could not do over the last several years."

There is additional support for this viewpoint from Richard (Rick) Hobson, vice president, sales and marketing for Gentry Homes, Ltd. "Today, there are not enough homes being built for the people of Hawaii, which is driving prices skyward. What sold for \$350,000 last year is selling for \$450,000 this year. In order to give people in Hawaii an opportunity to buy a new home, there has to be new communities, like Waiawa."

"There is room for more development on Oahu," says Christine Camp Friedman, president of Avalon Development Company and past president of the Hawaii Developers Council. "Kapolei is growing fast and the demographics are great for commercial developments. The new housing supply of approximately 800 units per year is certainly keeping the pressure on retail services within Kapolei and the Ewa area. I think the Kapolei/Ewa region will be where most of the successful new developments will occur in the next couple of years." She also believes Waipahu's industrial area will be revitalized and vacancies will become fewer. "We are reaching a critical vacancy point (overall on Oahu) of less than 2 percent. This allows rents to increase in areas that have been depressed. The lower Waipahu areas needed a new infusion of capital improvements and this is the perfect time for seeing new development as well as the renovation of existing facilities. Mill Town is almost sold out and I understand that new construction and spec warehouse developments will be taking place in this hot zone. Waipahu offers enterprise zone benefits -- tax credits and waivers up to seven years -- that should be enticing for companies to relocate there."

## **Economic Aid?**



Stanford Carr Development is creating the Cottages and the Villas in Hawaii Kai. Above, Rick Papa, project manager for Stanford Carr Development, oversees construction of the Colony — a four-story luxury condominium at the Peninsula in Hawaii Kai.

"If we want our economy to continue to grow and prosper, then the areas supporting economic growth need room for expansion," says Catherine (Cathy) Camp of A&B Properties, Inc. Camp, who is current president of the National Association of Industrial and Office Properties (NAIOP) Hawaii Chapter, explains, "One area that is extremely tight is the industrial market where there is low vacancy (much of the inventory available is very worn and in need of major refurbishment/replacement, and there aren't many larger spaces available) and quality in-fill industrial space is precious and highly sought after."



The Colony

Rents have been increasing in this sector, making redevelopment look more favorable to the developer -- the rents are at a point where one can finance and develop a parcel and still make a small profit. Recent transactions in Kapolei and the strong sales at Mill Town Industrial and Business Center show continued strong demand for industrial product. Retail development/redevelopment also is a growing area where we are experiencing the expansion of many large retailers on Oahu and the neighbor islands (Wal-Mart, Home Depot, for example) and new entrants into the Oahu market (Best Buy, for example) that probably are considering neighbor island expansion somewhere down the road." Camp also points to neighborhood shopping centers and malls that are experiencing higher occupancies due to the favorable economic outlook. "As occupancy increases, you will see more centers start to put money into refurbishments, replacing of aging exterior facades, etc. End of year 2003 vacancy rates (about 12 percent) support expansion of the office market without the addition of any new development. An exception, however, is the Kapolei area where there is little office space available. I believe there may be an opportunity for new development here." Camp says the hospitality sector also is enjoying growth because of the increased visitor interest in Hawaii. "Timeshare, fractional and resort residential are areas of continued development/growth on Oahu and the neighbor islands. In addition, many hotels will be converted into condo/hotels as demand for this product based on recent sales has been high." As to residential development,

(editor's note: see B.I.'s April cover story on Finance and Bonding) the residential market is expanding to where developers cannot seem to get enough product out fast enough. This is particularly true on the neighbor islands where housing prices have been increasing."

## **Growth — A Two-Edged Sword**

"The big problem," says Patrick O'Neill, director of sales and marketing for Stanford Carr Development, "is the swelling population growth -- Maui is a good example -- with a lack of residential development growth. There is a small vocal minority that has been very anti-development, but the majority of local families on Maui are begging for homes and their demands are beginning to have an impact. The Big Island also is feeling growing pains. The housing market is not keeping up with the population growth." O'Neill says there is some anti-growth sentiment on the Big Island, visibly fueled by the Hokulea development controversy. Does he feel there is room for more developmental growth in Hawaii? It depends on the area in question. "In downtown Honolulu," he explains, "the only opportunities are in-fill projects. In the urban core, there is no land left. In Hawaii Kai, there are a few in-fill parcels available. There is room for growth out west -- in Central Oahu, for example. As to the outer islands, the big problem is water -- a restriction of nature."

Mark Richards, president/owner of Maryl Group, Inc., reinforces several of O'Neill's statements, and expands on some areas. "There is vast opportunity (for development) on Oahu," he says, "in Kapolei for example; 'Greater Honolulu' teardowns from the '40s and '50s plus in-fill; and the redevelopment of Waikiki and Windward Oahu. On the outer islands, Kona is booming within four Kohala Coast Resort nodes as well as Kailua-Kona. Hilo is very strong in multifamily rentals. Kauai is showing strong demand reflected in price escalation for single family and multifamily product, with new projects close to start up. Maui is showing strong demand (all residential)."

"There is room for development on Kauai," says Alan Smith, vice president and COO for the Garden Isle's Grove Farm. "Only 3 percent of the island's 500 square miles is urban." Smith emphasizes, "There is good job growth here, so we need more homes. Potential home buyers want the residential developers to hurry up and create the housing they need."

## **What a Difference a Year Makes**

Again, depending upon the project and the developer, there is a mixed reaction as to how the current year is shaping up compared to 2003.

According to Steve Metter, partner with MW Group, Ltd., there are several differences between 2004 and 2003. "We are seeing stronger military projects," he says, "and there is a stronger demand for housing. In addition, the industrial sector demand is strong -- there is less than 2.5 percent vacancy. The office market is improving and retail is getting stronger." Metter sees a definite need for specific areas of development -- "Housing, housing and more housing," he says, "including assisted living facilities and senior housing."



Prescott II at Ewa by Gentry, is nearing completion.

"This is a fast-paced year with 100 more closings than last year and six new developments coming up soon," says Schuler's Flood. "We also are finalizing plans to purchase land in Kapolei as well as on the islands of Hawaii, Maui, and Kauai."

Maryl Group's Richards sees 2004 as, "More of 2003, with a broadening out of demand in areas such as West Oahu and Kauai."

Haseko's Dunn reports, "For us so far, this year's sales have been stronger than in 2003. The rapid sales that took place in 2003 has limited the supply of new housing to be placed on the market this year."

"There is no comparison!" says Avalon's Camp Friedman. "By far 2004 has been the most dynamic year yet."

But not everyone sees 2004 as the best year in a long time. Bruce Barrett, vice president of sales and marketing for Castle & Cooke Homes Hawaii, Inc., for example, says, "Despite increased consumer confidence and strong product demand, we anticipate delivering approximately 75 fewer homes in 2004 than we did in 2003, primarily due to less availability of entitled lands in Central and West Oahu. Many other builders are experiencing this same impact."

Gentry, for one. "Production is just about half of 2003," says Robert W. Brant, president and CEO of Gentry Homes, Ltd. "This year, Gentry is projecting to close approximately 240 homes, compared to 2003, when we delivered 429 homes. Our current demand could easily match or exceed 2003 closings, but we don't have the homes to sell. The time it takes to prepare land for development and receive subdivision approvals is lengthy. This has pushed production deliveries into 2005."

"In Ewa by Gentry, we have over 5,800 homes built. The overall Ewa by Gentry plan calls for 9,000 homes. Gentry has received entitlements for the first phase which is planned for 6,000 units, 91 acres of commercial and industrial uses, two 18-hole golf courses, schools and parks."

## Hawaii's Inducements

A&B's Cathy Camp offers an interesting take on the question of 2004 versus 2003. "The favorable interest rates make many new developments pencil out," she says. "In addition, many investors locally and offshore are looking to invest in Hawaii. Although the favorable interest rate environment has lowered discount rates and cap rates, pricing on existing inventory has increased. There is more purchasing power available to start new developments."

Additionally, to an investor, real estate is attractive because of the lackluster aspect of alternative investments (stocks, etc.)."



Nestled between the mountains and the sea,  
Schuler's Sea Country development in Maui

Above left, Kassie Rogers, sales associate for  
Schuler Realty, with Keala Fuiaua, sales  
secretary, at the site of Schuler's Sea Country  
development in Maui

Michael W. Kosmin, vice president of sales and marketing for Centex Destination Properties Hawaii division tells us, "With our second Hawaii project coming on line at Ko Olina this month, 2004 will be even stronger than 2003." Kosmin and Hawaii division president Bruce Sloan explain the company's developmental philosophy and its activities in Hawaii: "Centex Destination Properties' primary mission is to build homes in resort areas throughout the United States. Certainly Hawaii presents itself with these types of opportunities on every island. We are very pleased with Kolea, our first project in Hawaii. It has been a tremendous success and we fully expect to build on this success in our second Hawaii community, Ko Olina Kai Golf Estates and Villas, located in the Ko Olina Resort and Marina on Oahu. Again, we are looking for resorts where Centex Destination Properties can strategically link our quality products with a master planned resort's vision of place and lifestyle. We are currently looking for these strategic alliances throughout Hawaii."

## If They Can Build It, They Will Come

Hawaii, indeed looks to be a "Field of Dreams" for many outside investors and developers. Reinforcing the comments by several of Hawaii's leading developers on the attractiveness of island real estate to outside investors, Haseko's Dunn adds that there has been a change in the ratio of mainland investors. "Their focus thus far has seemed limited to the second home market," he says, "and high rise developments."

Castle & Cooke's Barrett feels, "Mainland developers have impacted mostly the resort and military privatization projects. Although they have not had a major impact on the local residential new home market, they will put additional stress on an already tight labor pool." (Editor's note: See B.I.'s January 2004 cover story on military construction and the privatization update in April 2004.)

Avalon's Camp Friedman says, "Hawaii used to be the one-off investment location for a lot of investors from the mainland, but right now, large mainland developers are keyed in to Hawaii's dynamics and are trying to find new development opportunities." Exactly what the Centex people have explained to us.

MW Group's Metter agrees. "Yes, there have been a lot of mainland developers creating or desiring to create projects in Hawaii over the past few years."

SCD's O'Neill reports, "Several big companies have been coming into the state and making large residential and commercial purchases. They think Hawaii (real estate) is a big bargain." Which leads right into our next question:

## **Who Are the New Players?**

"There have been some mainland developers coming into the market as more demand has been demonstrated. But by and large, Hawaii is still a local market," says Maryl Group's Richards. He adds, "New developers on the industry scene include some of our own clients. For example, Exclusive Resorts, a Steve Case development on the Big Island." Robert Freeman, Maryl's vice president of development, speaks of plans for The Hawaii College of Pharmacy at Kapolei, a project on which Maryl will be working with developers David Monroe and Dee Dee Criswell. "It's a three-acre parcel," says Freeman, "that will house a 50,000 square-foot, four-story building. It's currently in the preliminary design stage and we are seeking architectural proposals." Monroe explains that the parent company of the project is mainland-based Pacific Blue Holdings, Inc. "The subsidiary company (of Hawaii development) is Pacific Educational Services, out of Las Vegas, Nev. This will be the first pharmacy college in the state of Hawaii and interest is substantial. We've already received 1,700 applications for the 140 student slots." Monroe also tells us that the parent company, which has developed pharmacy colleges in various parts of the country, plans to bring several pharmacy outlets to Hawaii. In additional development news at Maryl Group, Freeman mentions KukuiUla, a DMB, A&B and Maryl joint venture of single-family home sites in the Poipu area of Kauai. This project, too, is in the preliminary design stage.

Norm Wood, Maryl's senior estimator is working on the Maui Breakers Condos in West Maui. "It's in the design stage," he says. "Douglas Myers is the developer."

SCD's O'Neill says in addition to several acquisitions of local companies by mainland corporations, new players in recent years include Brookfield Homes and Centex. "Watts Homes is shopping around again," he says, "and Michael Fuchs, a founder of HBO has purchased a parcel of land in Mauna Lani that he is looking to develop."

## **Challenges and Concerns**

One of the questions B.I. asked those interviewed for this report was, "What are the main challenges facing developers in Hawaii? For example, is the problem many builders are having in obtaining insurance coverage -- especially in residential condominium projects -- impacting your projects and plans?"

"The real estate environment always has challenges, whether during periods of relative prosperity or weakness," say Kosmin and Sloan of Centex Destination Properties. "In prosperous times, the usual challenges include the supply of each of the components of our business -- land, people and materials. Here in Hawaii, we face challenges in each of these areas. To date, we have been blessed with good land positions and the hard work of the quality people that make up our internal staff, vendors, and subcontractors. We continue to be challenged every day (try securing adequate insurance for a condominium project). However, good people can rise to meet these challenges with success."



A Centex Destination Properties home at Kolea on the Big Island

"Developers face several challenges in Hawaii," says Schuler's Flood. "The first is that the demand for new homes has overwhelmed government agencies, making the wait for permits longer and longer. The second is that the cost of materials is rising rapidly, increasing the cost of building, and, of course, impacting prices. The third challenge is the shortage of skilled workers, which might become greater once the privatization of housing by the military begins."

"The same challenges everyone faces," says Gentry's Brant, "rising costs, including insurance."

A&B's Camp says, "Insurance costs for residential developments has increased significantly. Another challenge for some is the length of time it can take for a small retail owner to obtain a building permit for the build-out of retail space within a larger center. Other challenges facing developers are the availability of entitled land; the amount of time it takes to go through the entitlement process; the availability, or lack thereof, of the necessary infrastructure to support future developments. Many of Hawaii's sewer systems are aging; traffic continues to be a concern; and the availability of water can be an issue depending upon the island where development is being planned. For example, water availability is tight on Maui."



MW Group's Pearl City Self Storage, scheduled for next quarter

Haseko's Dunn and SCD's O'Neill say they have no problems in the insurance area. "The challenges," says O'Neill, "are the high cost of the land and the anti-growth sentiment. And the regulatory agencies still make it difficult -- it takes a long time to get entitlement -- and of course, that adds to the cost of the home. Developers on the average, make single digit profits -- a return of approximately 4 percent."

"There definitely is a statewide insurance problem," says Grove Farm's Smith. "In other challenges," adds Michael Furukawa, Grove Farm's vice president and assistant secretary, "the permitting process is slow and cumbersome. The conditions imposed are onerous and this all adds to the cost of the homes, which the consumer ultimately pays. Developers are responsible

for providing their own infrastructure, but the costs are difficult."



s for solutions to the challenges facing Hawaii's developers, Maryl Group's Richards says that his company is focusing on the design/build delivery format. "We are teaming with a variety of Hawaii's design professionals in order to lower overall production costs, reduce delivery time, and minimize development 'friction.' Maryl has \$10 million in residential condo liability coverage," he explains, "one of a few in the state — and that allows us continued participation in the residential condo market."

MW Group's Metter emphasizes the rising costs of materials and labor. "They're going up exorbitantly," he says. "And, of course, the permitting process is a problem." Metter feels there may be more of a problem once the privatization process begins, with an impending shortage of qualified labor. "There has to be a stepping up of apprenticeships, for one thing," he says. (Editor's note: See B.I.'s report on Apprenticeship and Training in this issue.)

Castle & Cooke's Barrett says, "Our industry's main challenge is to continue to meet the housing needs of our community, especially for today's children -- tomorrow's homeowners."

## Looking Ahead

What lies ahead for the industry in general and for specific developers?

- "I think if there is any place that has room for growth, that would be in Kakaako," says Avalon's Camp Friedman. "Kakaako is a location with high demand. Most important for developers (after market demand) is infrastructure that is already built and awaiting development. I anticipate that within the next couple of years, we will see more plans for high-rise developments in Kakaako. Outside of Oahu, we will see more luxury resort developments on the Big Island, starting with the newly-zoned Kohanaiki, a luxury residential development; more extensions of Hualalai and Kukio; completion of Mauna Lani's remaining land; and all or some of the land mauka of Kukio and Hualalai. We also will see an infusion of industrial and commercial developments on the Big Island with DHHL (Department of Hawaiian Home Lands) and DLNR's (Department of Land and Natural Resources) RFPs being completed and the developer selected. Lanihau properties' West Hawaii Business Park will bring on approximately 380 acres of new industrial mix use commercial projects to the market in the next year to support all of the new construction activities. Of course, we will see spot developments. As the market outlook increases, we are seeing more and more small developers -- those doing small lot subdivisions in in-fill projects."
- "The future looks terrific for Schuler Homes and Hawaii in general," says Flood. "The economy is good and should stay strong for several years. Mainland buyers are fueling some of the buying frenzy, but the bulk of the new home sales are still local buyers."

"High end condos will be very strong in Central Oahu," says MW Group's Metter. "And we really need more assisted living facilities on Oahu."

- "We have the greatest level of residential and commercial commitments in the company's history," says Maryl Group's Richards. "I am very bullish on the next five years; especially in Kona, on Kauai, and Oahu."

- "Major future developments are Waiawa, Koa Ridge in Central Oahu, the continuing development of the Campbell Estate land in Kapolei, East Kapolei, and Makaiwa Hills, plus the renewed interest in high-rise condominiums in Honolulu," says Gentry's Brant. "Our own future looks very bright. We have entitlements for an additional 2,800 units in Ewa by Gentry and we are working on Waiawa, which has entitlements for over 7,000, of which 6,000 are currently planned."

- "As long as interest rates do not increase too much, the future looks bright," says Haseko's Dunn.



Bruce Barrett, vice president sales and marketing, Castle & Cooke Homes Hawaii, Inc. (left) and Alan Arakawa, vice president of development and construction, at the site of Residence Six, American Classics

*Developers. Often in the middle of a tough, two-sided situation. They must meet the demands of a growing community and volatile economy, yet be sensitive to the fragility of the land and its limited resources in these islands. For those who truly care about the aina and its legacy for future generations (and this includes most of our local developers) the future with all its bright promise, holds many challenges.*