Hawaii Real Estate 2020 with Paul Brewbaker

April 9, 2020

Answers to Written Questions

Q. Slide/data clarifications: what districts are included in "Hilo" and "Kona "data?

A. I define Tax-Map Keys 1-4 as Hilo Side—Puna to Hamakua. TMKs 5-8 are so-called Kona Side. TMK 9 is Ka'u. The assignment is informal and does not correspond to any jurisdictional aggregation. Obviously, Honokaa is not Hilo and Hawi is not Kona, but those are examples of the East Hawaii Island and West Hawaii Island pairings represented in my definitions. The aggregations were designed to maximize the distinctions in prices of the different regions while minimizing the noise contribution any one TMK makes to the groupings. This may not be the way Realtors would conceive of the aggregations nor homebuyers or sellers, it was a statistical criterion—seeking to separate the home price distributions but also minimize each TMK's contribution to dispersion in the distributions which motivate my original inquiry. The work was done by a UH-Hilo student, Onan Masuoka, as a senior thesis project overseen by faculty members with me as an outside advisor. Masuoka's "line(s) of demarcation" segregated TMK 9 because it contributed more noise than signal irrespective of whether it was aligned with either East or West Hawaii aggregations. I realize North Kohala is kind of its own private Idaho—like Ka'u—but statistically it was determined that its price behavior aligned it more with West Hawaii.

Q. Can you express an opinion on the South Kohala area market (Waimea, Mauna Kea Resort, Waikoloa Village, Waikoloa Beach Resort, Mauna Lani Resort, etc.)?

A. Closed for the duration, eh? If Kona and Hilo airport—and, I mean, seriously, you guys need *two* 10,000 foot runways? sounds like somebody pulled the trigger prematurely—were to adopt the travel management protocols of Singapore or Taiwan, Big Island destination resort business could revive quickly. I mean, is a novel coronavirus a transportation security administration issue or what? (Common nouns.) So what *are* those guys doing now? Thousands Standing Around. Clearly we are at a disadvantage: federal government leadership is clueless and has no plan. State government leadership was slow to start but decisive once they did act; still, it's not clear what the plan is to revive tourism. Ultimately, the value of lodging inventory is derived from its utilization and peoples' willingness to pay for that. Hawaii needs to establish a reputation quickly as a safe destination—from a biological risk standpoint—and needs to establish the protocols to safely reintroduce air travel. That discussion is ongoing. My approach is to go full *Crazy Rich Asians*: everybody gets screened (temperature), and tested, and tracked continuously during their stay so that the tracing can be done (algorithmically). The technology already exists. Whatever they do in Singapore or Taiwan, I would say we should do here, then South Kohala can revive. Otherwise, *Waiting For Godot.* Check out: https://www.youtube.com/watch?v=uAaDC0lv13s.

Q. Could you clarify the graph about Kauai pricing for sellers and buyers?

A. Perhaps I don't understand the question. The median price, only depicted for single-family homes on Kauai, is the price sellers receive and buyers pay, the same price. It is associated with a closing date in your MLS. The median price is that which separates the upper and lower halves of the distribution of sales—or purchase—prices (same thing). The median is distinct from the mean price, which is the arithmetic average of all prices (and is the so-called first moment of the underlying distribution of observed prices; its standard deviation is the second moment). Because the distribution is skewed (the third moment), the median—the halfway point—is between the mode (the most frequently observed price, below the median), and the mean or average price (above the median). All are measures of "central tendency" of the price distribution. I highlighted the fourth moment, kurtosis, which informally characterizes how many high-end transactions there are in the tail of the distribution or, equivalently, how much prices are bunched up around the central tendencies. Kurtosis was observed to rise *before* median prices begin to accelerate during the late-1990s/early-2000s housing cycle. Kurtosis even rose (modestly) during the mid-2010s, a more recent interval in which price movements were not obviously cyclical. Price movements were *exponential* at a constant rate (or, technically, were linear in natural logarithms). I calculated that appreciation rate around 5.5 percent *per annum* from 2011-2019, or so. Note that the *absence* of a cycle in 2010s Kauai price movements is as remarkable as the *presence* of a cycle (of large amplitude) coming out of the late-1990s into the early-2000s. The early interval comprised the so-called Sub-Prime Bubble in housing valuations: kurtosis surged in advance of the bubble. That is, the higher-end prices tended to lead at the front end of the cycle, and prices clustered around the middle of the distribution—where most of us live—tended to follow. A more modest version of this leadership was evident more recently, during the mid-2010s, and passed by the late-2010s. Unlike the 2007-2008 financial crisis and the 2008-2009 recession, however, the boom and bust (burst) of the "rational speculative bubble in housing asset prices" during the 2000s was *not* replicated during the 2010s. The former roller-coaster in valuations was replaced by an escalator. During the decade of the 20-teens, no financial imbalances accumulated to serve as precipitants of the current economic recession. The current recession is entirely exogenous in origin—a result of a global coronavirus pandemic event having nothing to do with housing, mortgage lending, or credit conditions generally. In the same way, the 9/11 event in 2001 was entirely exogenous, and proved fleeting in its impacts on residential real estate. With adherence to social distancing and sheltering in place during the current crisis so, too, could the current event be fleeting in its adverse impacts. It all depends on what protocols are put in place to contain the outbreak once the current mitigation strategy has achieved its objective of halting more rapid spread of the infection. Unfortunately, this is highly uncertain.

Q. On the slide or residential listings exhibiting a drop in listings, are listings *new* on market or do they include "back on market" units falling out of escrow?

A. Hawaii Information Service included listings released since January 1, 2020, excluding only 'Hold' status listings. I don't think it represented a surge in "back on market" units excluded from the data set after having been *relisted*, however. I've seen the national data: listings (the supply of homes for sale), plummeted across the country beginning in early March. I thought it would be interesting to see if the same phenomenon also was present in Hawaii Island and Kauai data (combined). It was.

Q. Will emotional home-buyers wanting to finally leave the mainland to live in Hawaii, with interest rates are so low, be a significant influence on future housing demand?

A. I suppose it depends on what is meant by "emotional." People suddenly deciding they love the idea of living on the Big Island rather than the Upper Peninsula of Michigan in the dead of winter might have an emotional motivation, too ("I've really grown to *hate* winter.") I have heard real estate experts recently conjecturing, however, that among the more enduring lifestyle changes and shifts in residential real estate investor preferences emerging from the coronavirus pandemic may be a greater desire for rural habitation away from contagion risk-laden urban environments, where density is a big part of the transmission mechanism. A variant on this hypothesis is that Millennials not yet fully invested in the housing market, or those who have begun building some home equity, as part of a generation more adept at using information technology to exploit self-employment opportunities and more capable of working remotely (telecommuting), more mobile as a consequence and less tied to habitation in dense urban environments, might constitute a material age cohort in terms of future housing market impacts. Recall that a generation of Baby Boomers disenchanted with American culture "tuned in and dropped out" to create a generational wave of urban-to-rural migration in the late-1960s and 1970s. For years a large portion of the membership in the Realtor Association of Maui seemed to comprise such individuals (hippie joke).

Q. The #1 Seller Question I get: Should I put my home on the market now or should I wait? How long should I wait? #1 Buyer Question I get: Should I buy now or wait? Is there an expectation that prices will drop giving me a chance to get a better deal?

A. Read my lips: I am not an investment advisor. If I knew answers to questions like this I wouldn't be doing this job. Seriously, the last time I made the mistake of answering this question was in the summer of 2005, when I opined to the largest gathering of Realtors on Kauai I have *ever* seen, that it was over, that it was the peak of the valuation cycle, and it was nothing but downhill from that point forward. Audience members complained, "but we just had our *best* year!" (By the way, "your best year" would be a good working definition of *the peak of the cycle*.) When asked "How long should I wait?" (*déjà vu* OMG) I made the mistake of saying they should wait until October 27, 2012. That shut them up. The Realtors all marked the date in electronic calendars using the little stylus that came with their new Palm Treos. And then I lived in terror for seven years waiting to see if my sarcasm turned out to be correct. For years I would get “six-degrees-of-separation” emails asking me if the urban myth that things would get better again after October 2012 was true. You’re asking me if the fake news that I invented *before Fakebook*, something you heard through the coconut wireless was true? It was a nightmare. However, the Kauai Board of Realtors is still inviting me back, so I infer that it all worked out. Coincidentally (or...was it omniscience?), I now run those regressions in the graphs estimating annual price appreciation rates with starting points around 2011 plus or minus. Proof that being lucky is more important than being smart.

Q. Can you comment on the Airbnb, VRBO, STVR, etc. market?

A. I alluded to this in my remarks but I don’t think the way normal people do about undocumented vacation rentals. I used to be a hater, thirty-five years ago. I grew up in Kailua, on Oahu, which basically invented undocumented vacation rentals. Then Honolulu banned them, in 1989. After thirty years you would think people would have moved on. In the appendix to my slides I document that *all* of the net growth in Oahu lodging inventory since 1989 comprises undocumented vacation rentals. (The same is “only” true for the last 28 years on the Neighbor Islands.) To me they’re like undocumented immigrants. You like them when they do the work nobody else will do. Otherwise, put them in cages. Honolulu’s City Council in 2019 voted *unanimously* (oh SNAP) to double-down on enforcement *of the 1989 vacation rental ban*. That’s like light speed for credible enforcement threats. Personally, I think the dichotomization of residents and tourists increasingly is anachronistic. It comes from the world when visitors sailed over to Pier 8 on the *S.S. Lurline* with Gidget and then went on a three-hour cruise on the *S.S. Minnow* with Gilligan. A three-hour cruise. The weather started getting rough, the tiny ship was tossed. If not for the courage of the fearless crew...you get the picture. Honolulu Lulu, queen of the surfer girls (https://www.youtube.com/watch?v=6j0Lgk1jc9M). Blue Hawaii (https://www.youtube.com/watch?v=y4vKzs0G3E4). It’s an attitude from the early- to mid-20th century. Stay at the Royal Hawaiian, we charge you too much for everything. Old School. In the 21st century—it’s the 20*20s*—search and matching apps lowered the information asymmetry which prevented travelers from finding habitation outside high-density conurbations controlled by oligopolistic lodging brands. For thirty years their market power has been secured by protectionist policies maximizing their economic interests: real Hawaii tourism receipts have not changed since 1989 (real visitor expenditure was the same in 2019), but the share of total receipts accruing to lodging has increased from 30 percent to 40 percent. They *meant* to do that. It’s literally called *exclusionary* zoning. Then hosting apps also lowered the barrier to entry in the lodging industry. Both demand (search/matching) and supply (entry), facilitated by apps, have changed housing markets in destinations like Hawaii but, observably, housing valuations during the 2010s despite the explosion of vacation rentals have appreciated at *stable* rates ranging from 4 percent (Oahu), to 5 percent (Hilo) to 6 percent (Kauai) to 7 percent (Kona). (At any rate, building more housing—which is already needed—would mitigate any incipient housing affordability problems created by vacation rentals. Many vacation rentals’ makai-orientation suggests they are not unduly constricting *affordable* housing inventory.) I’m inclined to think that *management* of tourism's negative externalities (congestion, environmental degradation, cultural dilution) is a *necessary* and sufficient condition for maximizing social welfare. At this Hawaii has failed miserably. The same smartphone-based tracking and tracing technology to mitigate entry by coronavirus-laden air passengers also could mitigate tourism's other negative externalities, for example, using geolocation and dynamic pricing (what Uber calls surge pricing). Who said the trail is free? Destination management can mitigate problems of overtourism, but prohibition is not management. So, how recent biological events influence *investor* decisions to buy, hold, or sell vacation rental properties depend entirely, it seems to me, on *public policy* towards them in Hawaii. My impression is that the Neighbor Islands continue to grope towards an optimal vacation rental management and property tax structure. This makes sense to me. I have no reason to believe the jurisdictions in Hawaii are sophisticated enough to adopt the technology necessary for management of either coronavirus or tourism externality problems—social distancing works up to a point, but Hawaii would have to be Singapore or Taiwan to go the full distance. I find this to be implausible, but some version of it is desirable. Either way, believing that vacation rentals are going to go away because *government* said so is like believing MMORPGs (massive multi-player role-playing games) are going to go away because your mom says you spend too much time playing them. Good luck with that. Hosting apps democratized the lodging market in the 2010s, making it accessible for small investors on the supply side and for a more diverse range of traveler preferences on the demand side. I understand *why* policy-makers choose to buttress the political and economic power of global corporate lodging brands. I don't understand why people assert that export-led economic growth—which for Hawaii *means* tourism growth—and natural and cultural resource stewardship cannot co-exist. *How* you do it matters, not whether you do it. It's easier to pretend that prohibition works. It did for alcohol, after all. It did for premarital sex. It did for interval ownership (timeshare). The list goes on and on.

Q. In Poipu we have noticed that all the second home people have flown in and are occupying their normally empty home. Is anyone else in the second-home market seeing the same influx? The conclusion being we will not be seeing a sell-off in that market. People bought these for fun (maybe a hideout). Now they are happy they have the hideout.

A. Word.

<u>**Economic Recovery Questions**</u>

Q. Some people think we will have a "hockey stick" recovery. Can you also discuss how a years (plural)-long recession will affect the real estate market on Hawaii Island?

Q. I realize it may depend based on how we mitigate/continue to respond, however what is your best guess based on the data you shared as to when would be "safe" to return to business and tourism as usual (or unusual - new normal)?

Q. Once we get back to a New Normal, do you anticipate price levels pushing upward quickly due to all the money the central banks are pushing into the system?

Q. Do the data and analyses support an extension of the current social distancing guidelines and shutdowns past April 30th? What could we be looking forward to, knowing Paul probably doesn't have a crystal ball? When could business resume?

A. The emphasis has to be on *protocols* for prudent economic recovery and a restoration of economic activity while maintaining prudent mitigation of further pandemic health risk, and answers to all of these questions are *contingent* on the extent of our success establishing and maintaining these protocols until a version of herd immunity or widespread vaccination can augment the prospective immunity which may—but is currently not known with certainty—accompany prior exposure to the novel coronavirus. On these issues I cannot overemphasize t he value of a compendium of papers on precisely these subjects at the University of Hawaii Economic Research Organization web site: https://uhero.hawaii.edu/how-to-control-hawaiis-coronavirus-epidemic-and-bring-back-the-economy-the-next-steps/.

Here's my stab at some of the questions:

1. Between the V-shaped, U-shaped, and L-shaped recoveries I've found the hockey-stick/Nike Swoosh/Reverse-J trajectories—i.e. "none of the above"—most compelling. There is always some overshooting at the outset. With biological risk the trick is not to release the Kraken (https://www.youtube.com/watch?v=38AYeNGjqg0) as you ease into the New Normal. When the U.S. has experienced years-long recession it has generally occurred because countercyclical economic policy was underdeveloped (the 1930s) or inhibited by political complication (America in 2009, Europe in 2011, Japan for thirty years). Notably, this (political complication) does not seem to be true currently. A long, drawn-out recession would be averse to *all* investing, not just residential real estate as an asset class. Still, I think we have a shot a sharp, V-shaped front-end, and can look across the chasm to an engineered—and vigilant—science-led economic recovery.
2. I actually believe that if my biological projections are right Hawaii will find itself at month-end (entering May) in the position China today finds itself, and Singapore, Taiwan, and South Korea are working with: how to sustain mitigation by returning economic activity with persistent and pervasive social distancing for a year or more.
3. Preconditions were so *dis*inflationary prior to the biological crisis, and risks of secular stagnation so much more profoundly of concern after a decade of inflation failing to manifest despite unprecedented quantitative easing and central government debt-financing, that I don't have the same concerns about incipient inflation I once did, relative to QE. For one thing, pulling on a string—the Fed raising interest rates to stifle incipient reacceleration of inflation—is something to which they have carefully built commitment credibility since Paul Volker became chair in October 1979. Forty years; I'm a believer. You tell me if today's Fed Chair Jay Powell sounds like someone who is cavalier about incipient inflation risk (https://www.federalreserve.gov/newsevents/speech/powell20200409a.htm and check out 11:30-13:58 at https://www.brookings.edu/events/webinar-federal-reserve-chair-jerome-powell-on-covid-19-and-the-economy/).

4. The way I would put it is that the restoration of business has to occur *in the context of continued social distancing* while the evolution of public health policy and what I have called protocols for an economic reboot unfolds.

I also *highly* recommend a recent webinar with former Fed Chair Ben Bernanke. If you need to be schooled about where things are headed this would be the way to do it: https://www.youtube.com/watch?v=cj058HjciQw.

Supply Chain Questions

Q. Reports are surfacing on the mainland that food supply chains have been disrupted from farmer to customer, especially in the food service sector. Are you aware of any explicit plans at the state or county level for non-market supply chain support to ensure that adequate food supplies continue to be distributed statewide? For example, are plans being made to divert local food production from export to in-state distribution?

Q. Can Paul express an opinion on how the pandemic will affect cost of materials for construction projects, as well as the ability to obtain items, as well as what changes are predicted in shipping that could delay construction projects.

A. I treated these questions in the discussion and refer you to those comments. Supply chain disruption, even in building materials, has been extensive but my impression is that the fabric of distribution as a whole remains largely intact. I tend to see these problems as opportunities for profitable solutions. "Filling the puka" is just arbitrage, to oversimplify. Buy low, sell high.

Mortgage-Related Questions

Q. The mortgage bankers are sounding the alarm that the Federal Reserve's emergency purchases of bonds backed by home loans are unintentionally putting their industry at risk. The Fed, in an emergency effort to forestall mortgage market dislocation, has been purchasing hundreds of billions of dollars amount of MBS, causing their price to rise sharply and swiftly. That forced enormous losses on lenders who had sold these securities short as a hedge. The result is chaos in the mortgage banking industry, and a shutoff in new origination. That in turn will suppress home purchases in an already-weak market. The Fed suddenly reversed course Friday morning and allowed mortgage prices to fall sharply, as an emergency measure to relieve the mortgage bankers. What will happen now and how will this impact the residential real estate market?

Q. Comment on current forbearance policy?

Q. If buyers purchase *during* the pandemic with a F/F backed loan, are they able to qualify for loan forbearance?

A. I can't speak to some of the credit specifics, although I imagine that there is a Frequently Asked Questions (FAQ) part of the Mortgage Bankers Association web site, for example, which might have answers. I heard the MBA's chief economist talk about the disruptive character of the Fed's abrupt intervention secondary mortgage markets last month but I believe that the initial shock and awe ultimately gives way to the primary intent of the asset-purchase intervention, which is to provide liquidity to and maintain functioning of those secondary markets for mortgage-backed securities. Jay Powell today talked about a commitment of $2.3 trillion in asset purchases; the Fed's balance sheet is back to a starting point around $4.5 trillion, so he's talking about increasing the size of the Fed's balance sheet by more than fifty percent. Not that this is *not* "printing money." If you are concerned about the growth of the money stock, simply look it up (https://fred.stlouisfed.org/series/M2). As I mentioned in the discussion, quantitative easing is all about providing liquidity to a financial system to prevent it from freezing up. An erosion of investor confidence implies a need for more liquidity. Think about the portfolio reallocation: investors flee to the safe haven of cash—selling stocks, selling bonds (like mortgage-backed securities). If there is an increase in the precautionary demand for liquidity, then the Fed's job is to increase the supply of liquidity. Confidence *is* liquidity. Look at the data: that's what's happening. These guys invented quantitative easing, and have taking it to the *n*th degree in the current situation. I have full confidence in their approach, but everything you ever need to know about it is posted at https://www.federalreserve.gov/newsevents.htm. Read what these people are saying, and stop watching cable news. Believe me, you will feel a lot better.

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