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Smart condo buys back on Oahu

Oahu's budding real estate recovery hasn't left condominiums behind, and investors and owner-occupants alike are taking notice.

According to real estate professionals, low prices and low mortgage rates -- recently around 6.75 percent -- have enabled many young couples, single professionals, retirees and investors to make condo purchases at prices not seen since the early 1980s. In fact, condominium buyers may now even have a monthly mortgage payment closer to what it would cost to rent the unit, also not seen since the early '80s.

According to a report recently issued by Mike Sklarz, Prudential Locations real estate sales and research director, mortgage payments on a median-priced, fee-simple condominium -- $118,500 in April -- have actually fallen below average rent (based on a 20 percent down payment at the prevailing fixed 30-year mortgage rate of around 7 percent or less).

Along with the drop in prices and interest rates, the number of condominium listings has also declined dramatically -- almost 50 percent from the most recent market peak in 1991 and 21.9 percent from a year ago. Inventories in some areas such as Hawaii Kai, Kailua and Kaneohe have shrunk even further.

Return on investment

With real estate sales building steam, and the possibility of rental income covering mortgage payments, buyers once again are looking at Hawaii as a viable real estate investment.

"With interest rates and prices lower, monthly payments are so much lower, so rental return for investors has risen," said Ria Keltz-Remenar, mortgage consultant with Trans Pacific Mortgage Group.

Rental returns traditionally have been lower in Hawaii than elsewhere in the nation.

"In the United States, normal rental return on investment before expenses and debt service is considered to be 1 percent per month on the fair market value of property," Keltz-Remenar said. "But in Hawaii, it used to be as low as 0.25 percent to 0.3 percent."

The exception to that rule, according to Keltz-Remenar, was always Waikiki. "It always used be a little higher there -- from 0.4 to 0.6 percent because studios and one-bedrooms bring a higher percentage on rent."

Now, according to Keltz-Remenar, the rental return seen on regular rental properties is from 0.7 percent to 1.1 percent, and consistently above 1 percent return in Waikiki. She said the second-home buyer is the most common of the investors she has worked with on Oahu, with most interested in Waikiki. While occupancy rates are seasonally affected in Waikiki, Keltz-Remenar said long-term rentals make up about 85 percent of that market.

As another incentive for investors and owner-occupants, Hawaii's property taxes are currently among the lowest in the nation -- generally running around $55 to $75 per month on a property worth from $250,000 to $350,000.

Down payments and financing Keltz-Remenar notes there are attractive financing packages for both the local and overseas investor.

"There are some programs that will go up to 90 percent of the value of the property, although generally it is still at 70 percent, especially if you are an out-of-state investor," she said.

Although mortgage rates vary for the investor, Keltz-Remenar noted that rate-influencing factors can include which building is chosen, the investor's credit rating and where the investor resides.

For the local investor, things are a bit easier.

"With 20 percent down payment, we should be able to get an interest rate in the low 7's [percent] for them," she said.

Points imposed by the lender create another variable for the would-be investor. One point generally represents 1 percent of the mortgage amount. According to Keltz-Remenar, depending on interest rate and financing program, it should be possible to get a mortgage with zero points. But, if a buyer is willing to pay more points, he may be able to get a lower mortgage rate.

"It all depends on the financial strategy of the investor. If he tends to hold property for 10 to 15 years, then I would recommend he should buy down the interest rate," she said.

Some no-down-payment financing programs are available for owner-occupants without substantial savings accounts, but closing costs can be substantial.

However, if a buyer has enough for a 3 percent down payment plus minimal closing costs, the seller would be able to pay up to 3 percent of non reoccurring closing costs, such as appraisals and points, Keltz-Remenar said.

Leasehold or fee simple?

Costly and controversial lease-to-fee conversions, coupled with plunging property values during the state's economic downturn, have dramatically affected prices of condominiums -- both leasehold and fee simple -- since the early 1990s.

Homeowners in areas such as Hawaii Kai, were faced with astronomical lease-to-fee conversion prices asked for by landholders such as Bishop Estate.

The highest recorded lease to fee conversion in that area was $225,000 on a townhouse, said Mike Pang, principal broker with Monarch Properties, one of the few companies specializing in lease to fee conversions.

After 1994, the number of conversions then dwindled to just a few hundred each year, said Pang, as owners, nervous about the outcome and possible contentious negotiations with landholders, backed away. Now, there is continuing anxiety over the large remaining number of leasehold condominiums -- located in some 200 buildings -- coming up for renegotiation of lease rents between now and 2008, Pang said.

Keltz-Remenar said not all lenders are willing to take a risk on leasehold property, especially not knowing what lease renegotiations will bring. But low prices are attracting some investors to leasehold property.

Keltz-Remenar said a good sign for those wishing to buy a leasehold condominium is if some units in the building have already converted from leasehold to fee simple.

"That way you know it's possible to buy the fee and it's less likely the building could every be torn down," she said.

While most buyers would prefer the security of purchasing a fee simple property, some of the best deals are to be found on leasehold property. Two identical properties in the same building may vary greatly in price if one is fee simple and one is leasehold.

Finally, Keltz-Remenar said potential condominium buyers need to consider monthly fees in addition to their monthly mortgage. Maintenance fees, real property taxes and lease rent if the property is leasehold can mean an extra several hundred dollars per month in payments.

"If you see a great buy, well below other comparable properties, it could create problems with lenders," Keltz-Remenar said.

Because each building has its own popularity rating with lenders, some buildings are considered high risk, depending on owner-occupancy rate.