Property owners skirt the law

Despite city restrictions, the growth of an underground tourism industry puts a dividing wedge between communities

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The widespread proliferation of mostly illegal vacation rentals on Oahu is pitting neighbor against neighbor, highlighting the city of Honolulu's inability to enforce its own laws, and likely leaving millions of tax dollars uncollected.

Tourist interest in other Oahu areas beyond Waikiki, the state's most popular and profitable destination, has taken off over the past decades, especially as repeat visitors look for new experiences. The demand has led to a vast expansion of illegal vacation rentals, especially in coastal neighborhoods across Oahu.

Some businesses and community members welcome the visitors, who bolster the local economy and help homeowners who are saddled with high mortgages and taxes. But other residents counter that the volume of visitors hurts the quality of life in what were once sleepy residential districts.

While this black-market economy has sprung up across Oahu, Honolulu Star-Advertiser research shows that the North Shore and Kailua are the strongholds for illegal vacation rental activity. As many as 80 percent of these vacation rental owners may be operating outside of city restrictions, the research indicates.

"It's creating a lot of conflict and hostility. Kailua used to be a quaint, small town where everyone knew everyone. Now, it's a resort," said Donna Wong, a member of the Kailua Neighborhood Board who has lived in the suburb for 30 years. "The North Shore has a similar situation. Visitor traffic used to be contained to surf season. Now, they've got it 24/7, 365 days a year."

The illegal business boom comes despite the city restrictions, passed in the 1980s, aimed at curbing the spread of short-term rentals. A 1986 land-use ordinance prohibited vacation rentals outside of resort areas from being rented for less than 30 days, while a 1989 law prohibits new bed-and-breakfast homes in all zoning districts. It also required operators of existing vacation rentals to obtain a "nonconforming-use" certificate, which allowed for short-term rentals. In addition, occupancy in vacation rental homes was restricted to no more than five unrelated people, while bed-and-breakfast homes were limited to two rooms housing a maximum of four guests at a time.

Following a brief window after the passage of the law, the city Department of Planning and Permitting has not issued any more certificates. Through attrition, about 2,600 Oahu certificate holders were reduced to 789 transient vacation units and 39 bed-and-breakfast operations.

However, research from both the Star-Advertiser and the Hawaii Tourism Authority shows that the city has failed to oversee the industry. Rental property owners are blatantly violating regulations and the business has grown significantly.

Preliminary data from a new HTA-commissioned study shows that despite the city restrictions there may be 4,411 vacation rental units on Oahu, with a total of 9,103 bedrooms that can accommodate up to 24,334 visitors at any given time.

The lion's share of neighborhood complaints about the proliferation has come from the North Shore and Kailua.

According to Star-Advertiser research, 471 out of 587 North Shore and Kailua vacation rentals being marketed earlier this year on the popular online booking site Vacation Rental By Owner were potentially willing to rent for less than one month or take multiple bookings for the same unit in a one-month period. The "yes" rate for potentially illegal bookings varied from 78 percent in Haleiwa and Kailua to 87 percent in Sunset Beach and 100 percent in Waialua.

On top of that, the quality of these online vacation rentals varied from oceanfront mansions to windowless garages, and even a plastic storage shed.

ROGUE RENTALS

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AN ISLAND DIVIDED

Some economists, tourism industry leaders, and online vacation rental advocates say relaxing restrictions would bring what has been a largely underground market to code.

Besides, they say, it's hard to stop homeowners from taking advantage of established trends, especially when the cost of living in Hawaii is high and the practice is lucrative. The Star-Advertiser found that the median rate for North Shore and Kailua units advertised on Vacation Rental By Owner (VRBO.com) in May was $199 daily, $2,625 a week and $10,000 a month.

Advocates of expanding Oahu's vacation rental industry say doing so would fuel higher transient accommodations tax (TAT) and general excise tax collections. It also would provide for continued tourism growth.

The HTA hasn't taken an official position on vacation rentals, but it acknowledges that additional visitor units are needed to get airlines to add more seats to Hawaii.

Other supporters point to increased employment opportunities.

"There were no jobs in Kailua before all of the visitors discovered our vacation rentals," said Will Page, who publishes Kailua maps highlighting tourist-friendly accommodations, legal or not, and businesses. "Now, jobs and businesses are thriving. I earn my living from tourism, which has afforded me the ability to live and work in Kailua. Sure, there's more traffic, but we're doing fine. We've got way less than Kaneohe and they don't have one-tenth the vacation rentals that we do."

Critics of the vacation rental industry want illegal activity stopped and say that if growth is allowed it should be monitored.

They argue that illicit commercial activity, which is not covered by homeowners insurance, undermines the effectiveness of government, increases traffic and crime in residential neighborhoods, drains infrastructure and community resources, and reduces the supply of residential housing on an island that is grappling with an affordable housing shortage.

Even if Oahu relaxed some of its restrictions on vacation rentals, they say, it is unclear how many owners would choose compliancy since continuing their under-the-table operations produces high yields with little risk.

But while the issue may divide the community, illegal rental operators are clearly winning by default.

LOST STATE INCOME

Matt Curtis, director of government relations for online vacation rental giant HomeAway.com, said the more challenging a destination's regulatory environment, the less likely that landlords will comply. He said New York City banned short-term rentals in 2010, and now there are four times the number of listings.

"New York is missing out on $450 million in taxes," he said. "Successful communities have fair regulatory environments that are easy to comply with."

Vacation rentals play a vital role in the community, said Angie Larson, board member of the Hawaii Vacation Rental Owners Association, which lobbies for the mostly unlicensed industry.

While Hawaii's vacation rental industry is largely operating in secret, Larson said shutting it down would do more harm than good.

"Most of our members pay taxes, create jobs for themselves and others and play a vital role in stimulating tourism outside of Waikiki," Larson said. "They would like to operate legally, but they can't because of the moratorium. Others have lost their nonconforming-use certificates. The biggest mistake that the city made was not leaving a door open to replace the owners that left."

But Barry Wallace, executive vice president of hospitality services for Outrigger Enterprises Group, said vacation rentals must be made to operate legally.

Anyone conducting business under the table unfairly competes with resort condos, eliminating well-paying hotel jobs, he said.

"Because they don't pay taxes or have as many employees, they can undercut us," he said. "They've also substantially reduced the number of units that are put into our rental programs. Our program has shrunk by about 10 to 20 percent in the last three years and our payroll has had to shrink accordingly. We've had reduced hours and layoffs. "

Wallace estimated there are 4,000 traditional hotel condominium units in the rental programs run by Hawaii Vacation Condos by Outrigger and its competitors Hilton Vacation Club, Aston, Aqua and Castle.

"The online vacation rental industry is bigger than our entire hotel condominium industry," he said. "If they aren't paying, the government could be missing out on sales tax of $60 million or more and TAT of at least $25 million."

Since state tax records are private, the city does not know how many vacation rental owners and bed-and-breakfast home operators are paying taxes.

State statutes allow for substantial penalties and interest, and even possible criminal prosecution for short-term vacation operators who are not paying the appropriate taxes, said Mallory Fujitani, spokeswoman for the state Tax Department. "The issue is identifying and establishing that the owner and/or operator received rental income from short-term rentals," Fujitani said.

While Larson contends most of her members pay taxes, Lt. John McCarthy of the Honolulu Police Department financial crimes unit speculates that few do. McCarthy said HPD often investigates calls regarding vacation rental scams as well as neighborhood complaints about increased noise or crime from illegal rentals.

"I don't think that most would legitimize it by paying taxes," he said. "But, hey, even if the state is only losing out on some of the tax collections — that's significant."