UNIVERSITY OF HAWAIʻI SYSTEM
Legislative Testimony

Testimony Presented Before the
House Committee on Finance
Tuesday, February 23, 2016 at 2:00 p.m.
by
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and
Dr. Carl Bonham, Executive Director
UHERO
University of Hawaiʻi at Mānoa

HB 1735 – RELATING TO PROPERTY TAXES

Chair Luke, Vice Chair Nishimoto, and members of the committee:

As Executive Director of the University of Hawaiʻi Economic Research Organization (UHERO) and Professor of Economics, on behalf of the University of Hawaiʻi, we offer the following comments on H.B. No. 1735, which requests UHERO to study the effects of Hawaiʻi's low property tax rates. We cannot support the bill in its present form. UHERO does not have the capability to conduct such a study because it has no in-house expertise in state and local public finance.

Property taxes vary greatly across the United States. The 2015, 50-State Property Tax Comparison Study by the Lincoln Institute of Land Policy and the Minnesota Center for Fiscal Excellence finds that effective property tax rates on residential and commercial properties in Hawaiʻi are at or near the bottom in the U.S.[1] The most important reason for taxation is to raise money to pay for public services. Hawaiʻi has low effective property tax rates largely because the 1978 revision of the State Constitution required the State to turn over the administration of the real property tax to the counties. Hawaiʻi's State Constitution assigns the costliest functions of government to the state government; this includes the provision of K-12 public education which elsewhere in the U.S. is funded by significant amounts of local property taxes (and state aid). Hawaiʻi's low property tax rates reflect the lesser public service responsibilities assigned to the counties.

Another significant feature of Hawaiʻi's property tax system is that it is structured to shift the property tax burden disproportionately to non-resident property owners and visitors. This is achieved under Hawaiʻi's classified property tax system by setting the highest rates on visitor related properties—hotels and resorts, vacation rentals, and timeshares. In Hawaiʻi, the lowest property tax rates are levied on owner-occupied residential properties.

[1] https://www.lincolninst.edu/pubs/dl/3550_2891_Pay_2014_PT_Report.pdf

H.B. No. 1735 focuses on taxation of residential properties. The legislature's factual findings in Section 1 note that, because of Hawaiʻi's low property tax rates, the counties potentially forego additional tax revenues from "high-value homes and second homes." Many of these properties' owners are non-residents who do not pay Hawaiʻi's income tax but still use Hawaiʻi's infrastructure and services, and thus should pay their "fair share". Low property tax rates are also believed to negatively affect local residents because they encourage the building of high-end housing in Hawaiʻi "contributing to the high costs of land in Hawaii, driving up the cost of living and exacerbating our affordable housing and homeless issues."

It is important to recognize that the counties engage in a never-ending process of property tax changes. The opportunity to raise additional revenue by exporting local taxes to affluent non-residents does not escape county council members. Kauai County recently (2013) completed a major change of its property tax system after three years of deliberation. In Honolulu, a separate—Residential A—property tax classification was established in 2013 to tax, at a higher tax rate, residential properties valued at $1 million or more that do not have a home/homestead exemption. Ostensibly, the higher rate is aimed at second home and out-of-state wealthy buyers. Moreover, the Hawaiʻi County Council is considering changes to the county's agricultural exemption program to discourage fraud.

UHERO supports high quality studies on the economic effects of property taxes in Hawaiʻi. Rigorous research is essential in policy-making. In addition, the relationship between property tax rates, housing prices, and housing affordability is a complex one that has challenged many careful efforts to quantify.[2] A recent study of property tax rates and home prices in Shanghai and Chongquing finds that discriminatory higher tax rates on high-end properties drove buyers to lower-end (and lower taxed) properties and produced the unintended consequence of driving up over-all prices of lower-end properties and lowered the prices of high-end properties.[3] The requirements of H.B. No. 1735 are broader and even more extensive than the studies referenced above. HB No. 1735 also requires the analyses of the Hawaiʻi-specific effects of property taxes on land values, the real estate market, housing affordability, federal tax liability, and more. Each is a substantial undertaking that requires specialized expertise, money and time. With UHERO's existing 2.5 FTE faculty, and no in-house expertise in state and local public finance, UHERO does not have the ability to complete such a study. A temporary allocation of funds from the legislature would only make it possible for UHERO to use soft money funded support staff to contract with a public finance expert from outside of Hawaiʻi to complete the study. Given the complexities of the issues to be addressed,

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[2] See, for example, Jeffrey P. Guilfoyle and Ronald C. Rutherford. 2000. "The effect of property taxes on home values," *Journal of Real Estate Literature*, vol. 8, no. 2, pp. 109-129; also, Richard Cebula. 2009. "Are property taxes capitalized into housing prices in Savannah, Georgia? An investigation into market mechanism." *Journal of Housing Research.* Vol. 18, No. 1, pp. 63-75.

[3] ChongEn Bai, Qi Li, and Min Ouyang. 2014. "Property Taxes and Home Prices: A Tale of Two Cities," *Journal of Econometrics,* Vol. 180, No 1, May, pp. 1-15.

the time it takes for mainland consultants to get up to speed on Hawaiʻi's tax system, and the specialized expertise required, such a study would likely be very expensive and require much more than a year to complete. Instead, we respectfully ask that this committee consider ways to permanently enhance the capabilities of UHERO to address important tax policy issues. Hawaiʻi needs an economist whose primary expertise is in the area of state and local public finance and who is focused on informing policy-making.

SUBJECT: REAL PROPERTY, Study by UHERO on Property Tax Rates

BILL NUMBER: HB 1735

INTRODUCED BY: LOWEN, BROWER, ICHIYAMA, ING, JORDAN, KEOHOKALOLE, KOBAYASHI, C. LEE, LOPRESTI, LUKE, MORIKAWA, NAKASHIMA, NISHIMOTO, OHNO, ONISHI, SAIKI, YAMANE, YAMASHITA, Johanson, McKelvey

EXECUTIVE SUMMARY: This bill calls for a study on why Hawaii's property taxes are so low compared to other states, presupposing the low rates to be a bad thing. The bill proponents may have forgotten that the state doesn't own the property taxes any more; they have been the province of the counties since the late 1970s. We question why the state should be spending state taxpayer money on a county matter.

BRIEF SUMMARY: Calls for a report no later than 20 days prior to the regular session of 2017 on (1) the effect of low property tax rates in Hawaii on (A) land values; (B) the real estate market; (C) the ability of the workforce to afford and own a home; (D) the availability of affordable housing; and (E) Federal taxes owed by Hawaii residents, including any reduced taxes from a homestead exemption; (2) how Hawaii compares to other states with regard to property tax rates; (3) how many Hawaii residential property owners are not Hawaii residents; and (4) how many Hawaii residential property owners do not pay Hawaii income tax. Appropriates $_____ for the study.

EFFECTIVE DATE: July 1, 2016.

STAFF COMMENTS: The recitals in the bill describe the need for this study as follows:

> The legislature finds that Hawaii has the lowest property taxes in the nation. Although this makes sense for low- and middle-income residents who own an average single-family home, this causes the counties to potentially forego additional tax revenue from high-value homes and second homes.
>
> The legislature further finds that many individuals and families who spend time in Hawaii are owners of high-value properties and do not pay state income tax, instead maintaining resident status in another state with a lower income tax rate. However, these individuals still use Hawaii's infrastructure and services, and thus should pay their fair share.
>
> The legislature also finds that low property taxes can incentivize development of high-end, high-value properties, contributing to the high cost of land in Hawaii, driving up the cost of living and exacerbating our affordable housing and homelessness issues.
>
> Finally, low property taxes lessen the impact of the federal homestead exemption, which is intended to make property taxes more progressive.

Of these "findings" justifying the study, many of the propositions are questionable. The conventional wisdom as to why Hawaii has low real property taxes is that most other states provide schools at the city or county level, requiring them to be funded by a municipal funding source like a property tax; Hawaii has a state-run school system, which is funded by state funding sources like the income tax and the GET.

The bill bemoans the low property taxes as a cause for counties to potentially forego tax revenue. Nothing is making the counties forego revenue. Under article VIII, section 3 of the Hawaii Constitution, the counties now own the real property tax and have since the late 1970's. If they are concerned about foregoing tax revenue, they could simply pass appropriate ordinances to fix the problem.

The bill casts aspersions on nonresidents who don't pay state income tax, asserting that they still use Hawaii government services and should pay their fair share. Our income tax, however, is like the tax systems in most other states. Nonresidents get taxed on income with its source in Hawaii. Residents get taxed on income regardless of source BUT get a credit for tax paid to another state or country on income that has its source in that state or country. Taxpayers who are nonresidents need to be present in Hawaii for less than half the year, and presumably would use fewer government services than Hawaii residents who live and work here.

Then, the bill asserts that low property taxes lead to development of high-end properties that then drive up the cost of land and therefore the cost of living. So the remedy for this is higher taxes which, in a free market, can and do drive up the cost of living *by themselves*? In any case, why are we proposing to use state funds to pay for such a study when only the counties, and not the state, are affected by real property tax?

Digested 2/18/2016

TO: Members of the Committee on Finance

FROM: Natalie Iwasa
Honolulu, HI 96825
808-395-3233

HEARING: 2 p.m. Tuesday, February 23, 2016

SUBJECT: HB 1735 – Relating to Property Taxes – **Amendments Requested**

Aloha Chair and Committee Members,

Thank you for allowing me the opportunity to provide testimony on HB1735, which would ask the Economic Research Organization of the University of Hawaii to study the effects of Hawaii's property tax rates. Thank you for taking a look at this issue.

This bill specifically asks UH to look at how many residential property owners are not Hawaii residents. Some out of state property owners:

- provide valuable housing for residents of the state;
- are required to pay general excise tax on gross rental receipts if renting their properties; and
- are required to file Hawaii state income taxes if renting their properties.

Please also note that renting a property may generate a loss and therefore not require a payment of Hawaii income taxes. In addition, there may be other reasons a property owner would not be required to pay Hawaii income taxes.

Therefore, please consider amending the bill as follows:

- On page 3, change lines 3 and 4 to indicate filing of Hawaii income tax returns; and
- include a cross analysis of Hawaii residential property owners who live out of state and do not file Hawaii income tax returns.

These changes would provide better information about people who own residential properties in Hawaii that are not being rented to residents of the state.

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HAWAII STATE TEACHERS ASSOCIATION
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TESTIMONY BEFORE THE HOUSE COMMITTEE ON FINANCE

RE: HB 1735 - RELATING TO PROPERTY TAXES

TUESDAY, FEBRUARY 23, 2016

COREY ROSENLEE, PRESIDENT
HAWAII STATE TEACHERS ASSOCIATION

Chair Luke and Members of the Committee:

The Hawaii State Teachers Association <u>supports HB 1735</u>, relating to property taxes.

According to a study released in 2015 by the Lincoln Institute of Land, Hawai'i has the lowest or next-to-lowest industrial, commercial, and apartment property taxes in the nation, for both urban and rural communities. Similarly, a WalletHub.com analysis revealed, last year, that the islands have the cheapest residential property taxes in the country, yet only 57 percent of state residents live in homes they own.

While some people believe that a low property tax bill makes local housing more affordable, this belief it vitiated by the fact that islanders compete heavily with people from all corners of the world for home ownership. More importantly to HSTA, Hawai'i's public schools are not funded through property taxes, which are constitutionally directed to the counties. Since property taxes are not used to finance local schools, we lack a dedicated funding stream for public education, which is instead paid for, primarily, through the state's general fund.

This setup was as intentional as it is problematic. Big Five landowners and religious missionaries crafted a segregated school system to perpetuate class inequality and boost plantation profits. As I wrote in the Star-Advertiser last April:

> The Big Five wanted poorly educated workers to keep wages low and plantation profits high. Since land was owned by the wealthy few, Hawai'i, unlike its mainland counterparts, doesn't fund education through property taxes. Since property taxes are

not used, there is no dedicated source of income for schools, and instead public school funding comes from the general fund and has been perpetually underfunded. Today, Hawaii leads the nation in the percent of students attending private school. The cost of educating a student at Punahou School is about $26,000 per year, compared to $8,000 per year for a regular education student at a public school.

Rectifying the economic disparities evinced and propounded by our schools is a moral imperative. To do so, we must invest in classroom cooling, facilities repair and maintenance, vocational education, arts and cultural learning, lower class sizes, public preschool, and professional pay for teachers–all of which requires increasing education funding. All options for generating revenue must be on the the table, in our view, including the possibility of hiking or imposing a surcharge on property taxes to strengthen our children's future. Accordingly, we urge your committee to amend Section 2, subsection (1) of this measure to read as follows:

(1) The effect of low property tax rates in Hawaii on:

(A) Land values;

(B) The real estate market;

(C) The ability of the workforce to afford and own a home;

(D) The availability of affordable housing; [~~and~~]

(E) Federal taxes owed by Hawaii residents, including any reduced taxes from a homestead exemption; and

(F) Funding for public education.

To advance fiscal equity for our state's public schools, the Hawaii State Teachers Association asks your committee to <u>support</u> this bill.