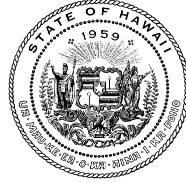
DAVID Y. IGE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



MARIA E. ZIELINSKI
DIRECTOR OF TAXATION

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

To: The Honorable Tom Brower, Chair
and Members of the House Committee on Housing

Date: Thursday, February 9, 2017
Time: 9:00 A.M.
Place: Conference Room 423, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 1012, Relating to Real Estate Investment Trusts

The Department of Taxation (Department) appreciates the intent of H.B. 1012 and provides the following comments for your consideration.

H.B. 1012 temporarily disallows the deduction for dividends paid by a Real Estate Investment Trust (REIT) for a period of 15 years, except for dividends generated from housing that is affordable to households with incomes at or below 200% of the median family income. The measure is effective upon approval and applies to taxable years beginning after December 31, 2017. The measure is repealed on December 31, 2032.

First, the Department notes that this measure relies upon the study "Real Estate Investment Trusts in Hawaii: Analysis and Survey Results" produced by the Department of Business, Economic Development & Tourism Research and Economic Analysis Division (Report) which was issued in September 2016. Section 1 of this Report concluded the dividends paid deduction resulted "in $36,000,000 in corporate income tax revenue being forgone that the State". However, it is very important to remember that this conclusion is not the equivalent to a revenue gain, if the deduction were disallowed. Meaning that the repeal of the dividends paid deduction is highly unlikely to result in a $36,000,000 gain to the State.

REITs must report all of its income on a tax return, but are also required to report all of its allowable deductions. This is because the dividends paid deduction alone will eliminate any tax liability. In other words, to properly estimate a revenue gain we must also consider the other allowable deductions that can be used to offset tax liability, as well as behavioral responses due to tax planning. The repeal of the dividends paid deduction is only one of many variables that must be considered in determining any potential revenue gain.

Second, the Department notes that it always prefers conformity with the Internal Revenue Code (IRC) where possible, as it provides clear guidance to both the Department and to taxpayers; the Internal Revenue Service has issued substantial guidance in the form of rules and regulations, and there are many court decisions regarding the various sections of the IRC. Conformity greatly minimizes the burden on the Department and taxpayers, thereby assisting compliance with Hawaii's tax law.

Finally, if the Committee wishes to advance this measure, the Department is able to implement this measure with the current effective date.

Thank you for the opportunity to provide comments.

Park Hotels & Resorts Inc.
Scott Winer, SVP Tax
1600 Tysons Boulevard
10th Floor
McLean, VA 22102
+1 703 584 7979 Main

WRITTEN TESTIMONY OF

SCOTT D. WINER

SENIOR VICE PRESIDENT, TAX

PARK HOTELS & RESORTS INC.

IN OPPOSITION TO H.B. 1012

BEFORE THE HAWAII HOUSE OF REPRESENTATIVES

COMMITTEE ON HOUSING

HONORABLE TOM BROWER, CHAIR

HONORABLE NADINE K. NAKAMURA, VICE CHAIR

HEARING ON H.B. 1012

FEBRUARY 9, 2017

On behalf of Park Hotels & Resorts Inc. ("PK"), thank you for this opportunity to provide our testimony on H.B. 1012 and its companion S.B. 1228. PK submits this testimony in opposition to H.B. 1012. PK is a publicly traded lodging real estate investment trust ("REIT") (NYSE:PK) that owns 67 premium branded hotels and resorts globally. Included within PK's portfolio of hotels are (i) the Hilton Hawaiian Village Waikiki Beach Resort located along Oahu's prestigious Waikiki Beach, and (ii) the Hilton Waikoloa Village located on the Kohala Coast of the Big Island of Hawaii. PK strives to be the preeminent lodging REIT, focused on consistently delivering superior, risk adjusted returns for shareholders that invest in the hotel sector. PK, like most REITs, has a long-term investment focus and is committed to creating sustainable value at its properties.

As you know, Congress enacted the REIT legislation in 1960 to allow individual investors the ability to own and benefit from professionally managed, institutional quality, income-producing real estate. As with all REITs, PK must meet multiple stringent, complex and costly requirements in order to maintain its status as a REIT, including: organizational requirements, asset holding requirements, passive income generation requirements, and importantly REITs must distribute at least 90% of their taxable income annually. Further, as REITs are passive real estate companies, they cannot actively trade in real estate properties without being subject to a 100% tax on the gain. In addition, because of the taxable income distribution requirement, REITs are required to continuously access the debt and equity capital markets to obtain growth capital.

By meeting these stringent, costly and complex requirements REITs are allowed to claim a dividends paid deduction ("DPD") essentially passing through their taxable income to shareholders. The structure does not "unfairly" advantage REITs, as the cost for such allowance is significant. H.B. 1012 and S.B. 1228, propose to "suspend" (for 15 years) the DPD for all REITs operating in Hawaii. We believe the DPD should not be eliminated. The elimination of the DPD would be inconsistent with federal tax rules and the existing rules of virtually all other states with an income based tax system. Additionally, we believe that our investment and the investments by other REITs in Hawaii are beneficial to the state and that eliminating the DPD would have the undesirable consequence of discouraging additional investments by REITs in the future. We believe the proposed legislation will not increase tax revenue for the state as the cost of doing business in Hawaii diminishes investment returns. Further, Foundations or pension funds could replace REIT ownership of real property if the DPD is eliminated. Foundations and pension funds generally are passive owners that pay no income taxes and do not make the same investments as REITs.

PK's two landmark, oceanfront resorts cater to residents from Hawaii and the mainland, and international travelers. PK's Hawaiian resorts provide significant economic benefit to the State of Hawaii. We have made extensive renovations over the last 5 years in excess of ~$228 million at Hilton Hawaiian Village and Hilton Waikola Village. Further, PK's economic footprint benefits the State of Hawaii in many ways, including:

JOBS: PK's hotels directly employ more than 2,731 employees. The payroll and associated benefits for these direct employees is in excess of $152,338,584 million.

CAPITAL MAINTENANCE: Over the next five years, PK will spend almost $200 million at Hilton Hawaiian Village and Waikoloa Village on capital maintenance projects.

CAPITAL IMPROVEMENTS. Given the long-term nature of our investment, PK is currently analyzing incremental capital investment at both resorts. These investments are sizeable and at various stages of feasibility / underwriting.

TAXES GENERATED BY PK in HAWAII:

- Payroll Taxes. Payroll taxes on employee wages totaled $10,401,795 in 2016.
- General Excise and Use Tax - Operations. The tax revenues generated from our operations totaled $24,210,890 in 2016.
- General Excise Tax – Rent. Because PK is a REIT and must use a lease structure, we are required to pay General Excise Tax on the rent paid between our related companies. Effectively a double taxation of the same revenue. We estimate this additional GET to be approximately $7,000,000 during 2017.
- Property taxes. Property taxes at PK's two resorts was $15,146,337 in 2016.

We believe that PK's hotels benefit the State of Hawaii and its residents tremendously in a variety of economic ways. We strongly urge that Hawaii not impose double taxation on REITs. If adopted, this controversial legislation would (i) put Hawaii at a competitive disadvantage, (ii) penalize Hawaii citizens who invest in REITs by reducing their returns, (iii) discourage REITs from investing in Hawaii, and (iv) would require PK to reassess the level of its investment or reinvestment in Hawaii. Further, this legislation would have a chilling effect on the motivation of REITs, like PK, which currently own property in Hawaii, to improve these assets and grow their positive economic impact through additional capital investment.

We thank you again for this opportunity to provide testimony against H.B. 1012 / S.B. 1228 and sincerely hope you consider our strong opposition to this proposed legislation.

Respectfully submitted,

Scott Winer
Senior Vice President, Tax

Legal Department
701 Western Avenue
Glendale, CA 91201

www.publicstorage.com
818.244.8080

February 7, 2017

Hearing Date: Thursday, February 9, 2017
Time: 9:00 a.m.
Place: Conference Room 423

The Honorable Tom Brower, Chair
The Honorable Nadine K. Nakamura, Vice Chair
House of Representatives, Committee on Housing

Re: Testimony ***Opposing*** Repeal of the REIT Dividends Paid Deduction - HB 1012

Dear Chair Brower, Vice Chair Nakamura, and Members of the Committee on Housing:

My name is Lily Yan Hughes and I am the Senior Vice President, Chief Legal Officer and Corporate Secretary of Public Storage. We are ***strongly opposed*** to HB 1012, and its companion bill, SB 1228. The bills would eliminate the "dividends paid deduction" (DPD) for Hawaii income tax purposes for real estate investment trusts (REITs).[1] The DPD is a central feature of the taxation of REITs; REITs get the deduction because they are effectively required to distribute their income to their shareholders, who are currently taxable on those dividends.

Enactment of HB 1012 or a similar measure would make REITs separately taxable in Hawaii for a 15 year period, imposing a double tax regime that is completely contrary to the accepted federal and state tax treatment of REITs. Imposing an added 6.4% tax on REITs operating in Hawaii predictably would lead REITs to redirect investments away from the state.

Public Storage and Hawaii. Public Storage is a real estate investment trust that is the largest owner and operator of self-storage facilities in the United States, with almost 154 million rentable square feet of real estate in 38 states. In the United States we have approximately 2,350 facilities and 1.3 million tenants. We own 11 facilities in Hawaii. In 2016, those properties generated more than $28.5 million of gross revenue and we paid the state about $1.3 million of general excise tax. For the 2016/2017 fiscal year, we will pay almost $2 million of real estate taxes in Hawaii.

Because we are taxed as a REIT, Public Storage is effectively required to distribute all of its taxable income to our shareholders. The shareholders then report and pay state and federal tax on those dividends. Our shareholders in Hawaii are taxable by the state on the full amount of our dividends (not just the limited portion of those dividends attributable to the 11 properties we have in the state), so the state benefits from the REIT regime.[2]

The preambles to the bills offer little to justify the proposed DPD repeal. The most apparent motivation is a misguided effort to raise added tax revenue. In fact, the bills may well

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1 The bills would continue to allow the DPD for dividends related to income arising from providing certain affordable housing.

2 We are confident that investors in Hawaii directly and indirectly hold significant PSA shares, but we cannot specifically identify our Hawaiian shareholders. Our common stock is publicly-traded on the New York Stock Exchange under the symbol PSA. Publicly traded companies typically cannot specifically identify their shareholders, as most publicly traded stock is held by depositaries in street name.

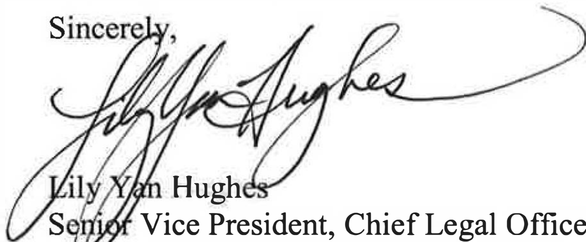
have the opposite effect. Imposing such an anti-business tax will reduce REITs' yields on Hawaii investment and encourage REITs to invest in other states. This can be expected to have adverse long term effects on the Hawaii economy and the state's tax collections. The preambles only other purported justifications are two spurious "fairness" points: (1) a suggestion that because REIT shareholders in other states do not pay Hawaii taxes on the dividends they receive, Hawaii taxpayers somehow are subsidizing the shareholders in other states; there is no subsidy, and of course, Hawaii REIT shareholders do not pay taxes to other states for REIT dividends attributable to properties in other states (and in the case of Public Storage, the great bulk of our dividends are attributable to properties in other states); and (2) asserting that repeal would somehow support fairness in treatment of similar but differently organized businesses; in fact, REITs are treated differently for good reasons, repeal of the DPD would unfairly single out REITs for double taxation, even though REITs, unlike regular corporations, are required to distribute their income and are subject to significant operating restrictions governing their income and assets.

Also, a key fairness issue supports continuing the DPD. If Hawaii breaks from the national REIT template and repeals the DPD, it would subject shareholders in Hawaii to double taxation on income that REITs earn in the state (Public Storage would pay tax to Hawaii on its Hawaii earnings, and our Hawaii shareholders would pay tax to Hawaii again when those earnings are included in their dividends), although shareholders virtually everywhere else would only be subject to a single level of state income tax.

We note too that no state that imposes income tax upon REITs (other than New Hampshire) denies the dividends paid deduction as proposed by HB 1012 (and SB 1228). Indeed, over the past decade or so, a number of states (*e.g.*, Idaho, Louisiana, New Jersey, North Carolina, and Rhode Island) have examined, and then rejected, legislation that would have disallowed a widely-held REIT's DPD in those states.

As when Hawaii's legislature considered similar proposals in recent years, Hawaii should decline to enact these bills, so that the DPD for widely-held REITs will continue. We respectfully request that you do ***not*** move HB 1012 or any similar bill forward.

Sincerely,



Lily Yan Hughes
Senior Vice President, Chief Legal Officer
& Corporate Secretary of Public Storage
lhughes@publicstorage.com
818.244.8080, extension 1537

cc: Department of Taxation
Department of Business, Economic Development & Tourism

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Cameron Sato
George Simson
Emmanuel Zibakalam

MAILING ADDRESS
P.O. Box 23404
Honolulu, Hawai'i 96823

www.adaaction.org

February 7 , 2017

TO: Honorable Chair Brower and Members of the Housing Committee

RE: HB 1012 Relating to Real Estate Investment Trusts
Support for hearing on Feb. 9

Americans for Democratic Action is an organization founded in the 1950s by leading supporters of the New Deal and led by Patsy Mink in the 1970s. We are devoted to the promotion of progressive public policies.

We support HB 1012 as it would deny the dividend exemption to Real Estate Investment Trusts (REITs). REITs help investors speculate on real estate investments. We need our housing units to be homes first and investments second. Furthermore this bill would help the state gain about 36 million in revenue needed for tax breaks for low income people, the construction of affordable rentals, and education.

Thank you for your consideration.

Sincerely,

John Bickel
President

TO:
Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

FROM:
Graphic Design Studio, Inc.
Petra Weggel
360 Papa Place #205
Kahului, HI 96732
(808) 205-1269

February 7, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Petra Weggel

President
Graphic Design Studio, Inc.

WAIKELE

An American Assets Trust Property

February 7, 2017

Honorable Tom Bower, Chair
Honorable Nadine K. Nakamura, Vice Chair
Committee on Housing
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Written Testimony to House Bill No. 1012, regarding Real Estate Investment Trusts
February 9, 2017 hearing at 9:00 a.m. Room 423

Dear Chair Bower, Vice-Chair Nakamura, and Committee Members:

My name is Pamela Wilson, and I am the General Manager of Hawaii Real Estate for American Assets Trust. American Assets Trust is a New York Stock Exchange-listed Real Estate Investment Trust (REIT) engaged in acquiring, improving, developing and managing premier retail, office and residential properties primarily in Hawaii, Southern California, Northern California, Oregon, and Washington State.

American Assets Trust owns four properties in Hawaii: The Shops at 2150 Kalakaua; Waikele Center; Waikiki Beach Walk and the Embassy Suites-Waikiki Beach Walk. We are committed to creating sustainable value at our properties. We have helped to nurture local businesses that provide jobs, increase business activity, and contribute to the state's economy (through generation of additional payroll, general excise, property taxes and income taxes earned by residents employed at these properties). We also play a valuable role in support of the local communities.

REITs allow ordinary Americans to invest in real estate. As with all REITs, we must satisfy many strict and expensive requirements in order to maintain our REIT status. One of the requirements is to distribute annually all of our taxable income to shareholders in order for all of our earnings to be taxed at the shareholder level. Another requirement is to own properties for the long-term, rather than to develop and sell properties. Notably, the REIT business model does not depend on "flipping" properties but on providing sustainable returns to our investors from distributions of current earnings and modest capital appreciation of our stock. Thus, we are incentivized (assuming state law regarding REITs does not change) to continue making additional investments in Hawaii at these properties. As a REIT that invests in multiple states, a double taxation would make Hawaii less attractive and encourage the placement of investments in other states that do permit the Dividend Paid Deduction (DPD).

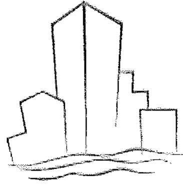
I submit this testimony not only as a shareholder who receives dividends from American Assets Trust but as a life-long resident of Hawaii, a constituent and a kama'aina with enough life experience to remember how dark and foreboding Lewers Street looked before the vibrancy of Waikiki Beach Walk, how the old International Marketplace, though quaint, was floundering, how all this influx of capital has redefined Hawaii as a world class destination.

I ask that you consider the very real financial contributions and community benefits that REITs bring to our State. Please hold Bill 1012. Thank you for the opportunity to submit this testimony.

Sincerely,

Pamela R. Wilson
General Manager, Hawaii Real Estate
American Assets Trust

94-849 Lumiania Street Suite 100 Waipahu, Hawaii 96797
Telephone: 808 671-7977 Facsimile: 808 678-8170
Email: pwilson@americanassets.com



Marshall W. Hung
Workforce Housing Developer for Honolulu
215 N. King Street, Suite 1000
Honolulu, HI 96817
W: 808.526.2027 ext. 6 F: 808.526-2066

Thursday, February 9, 2017

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

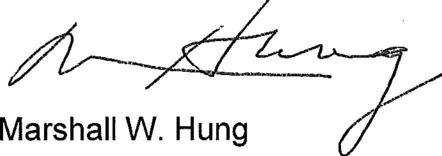
RE: Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

Dear Rep. Brower and Rep. Nakamura:

I support H.B. No. 1012 to have REITS pay State of Hawaii income tax.

Hawaii has a finite quantity of commercial property. To allow the revenue tax base that supports our island population to be decreased by these large amounts is playing with FIRE.

Respectfully yours,



Marshall W. Hung

Noah's Development, LLC

50 S. Beretania Street, #C-119C, Honolulu, HI 96813

February 7, 2017

Donna May Hayashida, Member
Noah's Development, LLC
50 S. Beretania Street, #C-119C
Honolulu, HI

Committee on Housing
Honorable Representatives Tom Brower, Chair; Nadine Nakamura, Vice Chair; and Members of the Committee on Housing

Hearing: Thursday, February 9, 2017
9:00 a.m.
Conference Room 423
State Capitol

RE: Testimony in Support of House Bill No. 1012, Relating to Real Estate Investment Trusts

Dear Chair Brower, Vice-Chair Nakamura, and Members of the Committee:

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Sincerely,

Donna May Hayashida
Member
Noah's Development, LLC

To: Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

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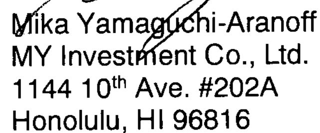
There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. *Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax*. **This loophole must be closed** so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Sincerely,



Mika Yamaguchi-Aranoff
MY Investment Co., Ltd.
1144 10th Ave. #202A
Honolulu, HI 96816

Taubman

February 8, 2017

Honorable Tom Brower, Chair
Honorable Nadine K. Nakamura, Vice Chair
Committee on Housing
State Capitol (conference room 423)
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill No. 1012 relating to real estate investment trusts

Dear Chair Brower, Vice-Chair Nakamura and Committee Members:

On behalf of Taubman Centers, thank you for the opportunity to provide our testimony in opposition to House Bill No. 1012, which is being heard by the Committee on Housing on February 9, 2017 at 9am. House Bill 1012 would disallow the dividend paid deduction for real estate investment trusts ("REITs") for a period of 15 years.

We offer the following background on Taubman, our business activity in Hawaii and an explanation of our tax treatment as a REIT. We are an S&P MidCap 400 publicly-traded and widely owned REIT engaged in the ownership, operation, management, development and leasing of 26 regional and outlet shopping centers in the U.S. and Asia.

Taubman and our shareholders are new investors in Hawaii and began construction in 2014 with Queen Emma Land Company and our partner Coastwood Capital Group to redevelop and revitalize International Market Place in Waikiki, Honolulu, Hawaii. Our shopping center, which opened on August 25, 2016, includes approximately 75 retailers and is designed to celebrate the rich history of the site and offer a Hawaiian sense of place that honors Queen Emma's legacy while adding vitality and appeal to Waikiki for tourists and residents alike. We are very excited about this project and to be part of the community in Hawaii.

As part of our commitment to the local community, during the year 2016 we recognized the following organizations with donations of cash; The Daughters of Hawai'i ($25,000), Hawaiian Music Hall of Fame ($25,000), Bernice Pauahi Bishop Museum ($25,000), The Waikiki Community Center ($30,000), Historic Hawai'i Foundation ($5,000) and Girl Scouts of Hawai'i ($2,500).

REIT Tax Treatment

We are organized, owned and operated in a manner to qualify as a REIT under the Internal Revenue Code for federal income tax purposes. A REIT is a conduit vehicle designed to allow many small investors to participate in real estate development and ownership. Some of the requirements to qualify as a REIT include (1) ownership by at least 100 shareholders, (2) a prohibition on being closely held and controlled by limiting ownership by five or fewer persons to no more than a 50% interest in the REIT, (3) meeting certain asset and income tests to ensure we are primarily invested in real estate and operate it for rental purposes as a long term investor, and (4) paying out all of our taxable income as cash dividends to our shareholders. Failure to meet these requirements results in losing our REIT tax status or in some circumstances harsh penalties like a prohibited transaction tax for not holding property as a long term investor in a rental real estate business. For meeting these stringent tests, Taubman Centers, like all REITs, is entitled to a deduction for dividends paid to our shareholders to reduce our taxable income. It is this deduction afforded in the federal tax law and permitted by virtually all other states that House Bill No. 1012 would eliminate and disallow for Hawaii corporate income taxation for a period of 15 years.

Because of the forced dividend requirement to distribute all of its taxable income, a REIT's taxable income is effectively taxed at the shareholder level by the state taxing the shareholder's dividend income in their state of residence. This allows for a single level of taxation at the shareholder level and no double taxation (i.e., it prevents taxation at both the entity level and again at the shareholder level) and is consistent with the treatment of investors in mutual funds that are treated as regulated investment companies for tax purposes. For REITs, state income taxation based on the shareholder's residence is the uniform tax treatment in virtually all states that impose an income based tax system. This results in state income taxation by Hawaii on dividends received by Hawaii residents who are shareholders in REITs that may own property and operations outside of the State.[1]

Please note that those taxpayers organized by corporations who do not qualify as a REIT are not entitled to a deduction for dividends paid in the computation of their taxable income. However, those taxpayers are not required to meet the restrictions on ownership and stringent operational and distribution requirements imposed on companies like us to qualify as a REIT and

[1] More than 9,300 individual investors in Hawaii receive $30 million in dividend each year
Brewbaker, P.H., Ph.D., CBE. (2015, December). *Economic Impacts of Real Estate Investment Trusts in Hawaii* http://thereitwayhawaii.com/wp-content/uploads/2016/02/REITs-in-Hawaii-final-December-2015.pdf (Prepared for the National Association of Real Estate Investment Trusts® (NAREIT)

entitle them to a deduction for dividends paid. This means they are not required to be long term investors and are not required to distribute all of their taxable income as cash dividends to investors.

REIT Economic Benefits in Hawaii

Approximately 80 REITs have invested in commercial real estate in Hawaii and are responsible for significant economic activity in the construction industry, resort industry, restaurant and retail industry, office and industrial leasing and others.[2] Taubman alone invested over $475 million for the redevelopment of International Market Place. In addition, it will continue to require investment to fund significant capital expenditures on a recurring annual basis to maintain the property to our standards and provide the highest quality shopping destination for our shoppers and tenants.

Such business activity generates substantial economic benefit for Hawaii, including providing jobs, as well as significant tax revenues for the State government. The tax revenues include substantial general excise taxes on rents from tenants, on the sale of goods and services at retail by the tenants, and on construction activities.

In year 2015 REITs were associated with more than 11,700 jobs representing labor earnings of nearly $500 million and $95 million in tax revenue in Hawaii. And in the past five years REIT funded construction activity is estimated to have generated $3 billion in Hawaii GDP. [3]

Taubman's International Market Place shopping center is expected to pay in this current year over $1 million in general excise tax and over $3 million in property taxes. To date we have paid in total over $1.5 million in local conveyance taxes. During the development of the center it resulted in employment of over an estimated 1,000 construction jobs and after opening is expected to create 2,500 permanent jobs (including employment by tenants), which generate both general excise tax revenues from construction work and individual income tax revenues from both the construction and permanent jobs.

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[2] Brewbaker, P.H., Ph.D., CBE. (2015, December). *Economic Impacts of Real Estate Investment Trusts in Hawaii* http://thereitwayhawaii.com/wp-content/uploads/2016/02/REITs-in-Hawaii-final-December-2015.pdf (Prepared for the National Association of Real Estate Investment Trusts® (NAREIT)
[3] ibid

Hawaii residents own an estimated $2.5 billion in real estate equity through REITs, mutual funds and exchange traded funds that distribute more than $105 million in REIT dividends annually. Approximately 9,300 individual investors in Hawaii receive $30 million each year in REIT distributions.[4] House Bill No. 1012 resulting in double taxation to REIT profits (once at the REIT level and again at the shareholder level) will affect after tax return on investment of Hawaii residents.

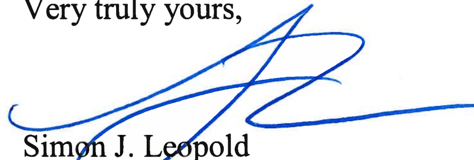
For more information on how REITs are making a positive impact in Hawaii please visit http://thereitwayhawaii.com/.

Such a policy change in state taxation of REITs is likely to discourage future investment by REITs in Hawaii, stifling the availability of capital and putting Hawaii at a competitive disadvantage versus virtually every other state when trying to attract capital for investment. Because investments by REITs generate so much economic activity and create so many local jobs in the State, disallowing the deduction for dividends paid not only would hurt workers in Hawaii, over the long run, it ultimately may result in less tax revenue for the State as its makes Hawaii unattractive for investment by REITs resulting in less economic activity.

For the foregoing reasons, we respectfully ask the Committee on Housing to hold House Bill No.1012

Thank you for your consideration of our testimony.

Very truly yours,



Simon J. Leopold
Chief Financial Officer
Taubman Centers, Inc

[4] ibid

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Douglas Emmett

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February 8, 2017

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

RE: HB 1012 Relating to Real Estate Investment Trusts – In Opposition

Aloha Chair Brower, Vice Chair Nakamura and Members of the Committee:

On behalf of Douglas Emmett, Inc. ("*Douglas Emmett*"), thank you for the opportunity to present testimony expressing concerns on House Bill 1012, which seeks to disallow the deduction for dividends paid by real estate investment trusts.

Douglas Emmett has been investing in Oahu for more than a decade. We currently own over 1,500 apartment units in three multi-family projects: The Villas at Royal Kunia, Waena Apartments, and the Moanalua Hillside Apartments. In addition, Douglas Emmett owns over 1.6 million square feet of office property in downtown Honolulu, including Bishop Square, Bishop Place and Harbor Court.

We are currently building 475 additional units of workforce rental housing at our Moanalua Hillside Apartments. The $120 million budget also includes a refresh for the entire Moanalua Hillside Apartments complex, with upgrades to the exteriors of the existing units, new landscaping and a new recreation center for all tenants.

Background of REITs. Congress created REITs in 1960 in order to enable individuals to invest in commercial real estate. REITs allow individuals to own a small portion of professionally managed, income-producing property, including offices such as Bishop Square, apartments such as the Waena Apartments, hotels, healthcare facilities, shopping centers, senior housing and storage facilities.

Federal law requires REITs to distribute at least 90% of their taxable income to their shareholders. Similar to other typical ways of holding real estate such as limited partnerships or limited liability companies, REIT's are essentially pass through vehicles in that the income earned by REIT shareholders (in the form of their annual dividends) is taxed at the shareholder level on the shareholder's individual tax return. These dividends are then deducted for tax purposes at the REIT level to avoid double taxation on REIT investors.

Although the dividends are deducted at the REIT level to avoid double taxation, REITs - just like any other property owner in Hawai'i - are required to pay all other taxes associated with their real estate holdings, including real property taxes, occupancy, and general excise taxes. By way of example, in 2016, Douglas Emmett paid over $5.1 million in real property taxes and over $3 million in general excise taxes. We expect to pay over $5 million of excise tax on our $120 million Moanalua Hillside Development. When completed, the additional units are projected to generate more than $500,000 of annual general excise tax. Without this development, this additional excise tax on both the construction costs and rental of the new units would not be generated.

REITs Provide Vitally Needed Capital for Hawai'i. As an island state poised for significant population growth over the next several decades, Hawai'i faces unique challenges. Economic growth, job creation and the development of workforce housing are only a few of these issues; addressing these issues will require capital and the primary sources of this investment capital will be from outside of Hawai'i.

In addition to being an important source of capital for Hawai'i, REITs bring real estate development and management expertise across a variety of asset classes. Douglas Emmett, for example, is adding critically needed rental housing. Other REITs are investing significant capital and bringing expertise in retail, hotels, self-storage, water parks, office buildings and medical buildings.

By imposing a double tax on REITs, Hawai'i will be at a competitive disadvantage compared to 48 other states.(1) REITs will compare prospective returns on investment, and over time, will likely shift investment dollars from Hawai'i to other markets. This means Hawai'i will lose a significant source of low-cost capital and development expertise.

We acknowledge that Hawai'i will remain an attractive place to invest, just not for REITs. We believe that tax exempt investors are the most likely source of capital large enough to replace REITs. Tax exempt investors, such as endowments, foundations and pension funds, pay no state income tax. These investors, currently have significant land holdings, CBD office buildings, hotels, and retail properties throughout the islands. Without REIT investment, their proportionate ownership share is likely to grow.

REITs Contribute Significantly to GDP and the Labor/Finance Markets in Hawai'i. Over the past five years, REIT-related construction activity generated an estimated $3 billion in Hawai'i GDP. In 2015 alone, REITs supported more than 11,700 local jobs and labor earnings of nearly $500 million. REITs also work with local banks on numerous financings and refinancings; Douglas Emmett is proud to have the four major Hawai'i banks as lenders.

We believe the elimination of the dividends paid deduction is unlikely to make up for the loss of GDP, jobs and associated income and excise taxes generated by REIT activity. The DBEDT study confirmed that its numbers did not take into consideration "how REITs would change their behavior if the DPD were repealed." According to the State of Hawai'i Department of Taxation:

> ***. . .if Hawai'i eliminates the dividends paid deduction, taxpayers may respond in ways that reduce substantially any latent tax liability, such as by claiming other deductions that are presently not reported on their income tax returns.***

Accordingly, once these deductions are applied, the DBEDT projected revenue figures are likely to significantly decrease and Hawai'i could lose more tax revenue from foregone economic activity in response to eliminating the DPD than would be gained in corporate income taxes.

1. Excludes New Hampshire which is the only state to eliminate the DPD.

House Bill 1012 Imposes a Double Tax on Hawai'i Residents. House Bill 1012 will negatively impact investors in REITs that own property in Hawai'i, including Hawai'i residents and Hawai'i pension funds. Should Hawai'i choose to double tax REITs, dividends coming from Hawai'i properties to these Hawai'i domiciled investors will be unfairly penalized.

REITs ultimately mirror other traditional real estate holding structures such as partnerships and limited liability companies. Profits from the real estate are distributed to the ultimate owners – in a REIT's case, its shareholders. Jurisdictions in which REITs invest benefit from REITs access to capital, development activity, and property management expertise as well as from the jobs, revenue and taxes generated by REITs. REITs pay real property and excise taxes, just like other local real estate owners.

As a stakeholder in Hawai'i, Douglas Emmett believes HB1012 will eliminate an important source of capital that generates substantial local economic activity. Hawai'i could lose more tax revenue from foregone economic activity in response to DPD elimination than would be gained in corporate income taxes. Inasmuch as House Bill 1012 appears to be outside of the best interests of the residents of Hawai'i and the objectives of the State to encourage investment and the growth of Hawai'i's economy, we respectfully ask that you defer Bill 1012.

Sincerely,

Kevin Crummy
Chief Investment Officer, Douglas Emmett

NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

WRITTEN TESTIMONY OF

STEVEN A. WECHSLER
PRESIDENT & CEO
NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS
IN OPPOSITION TO H.B. 1012

BEFORE THE HAWAII HOUSE OF REPRESENTATIVES

COMMITTEE ON
HOUSING
HONORABLE TOM BROWER, CHAIR
HONORABLE NADINE K. NAKAMURA, VICE CHAIR

HEARING ON H.B. 1012

FEBRUARY 9, 2017

1875 I Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401 www.REIT.com

Chair Brower, Vice Chair Nakamura, and members of the Committee on Housing,

The National Association of Real Estate Investment Trusts (NAREIT)[1] thanks you for this opportunity to submit testimony in **strong opposition** to H.B. 1012, which would "temporarily" (for 15 years) eliminate the dividends paid deduction (DPD) for REITs except with respect to certain dividends from affordable housing.

NAREIT opposes H.B. 1012 because it is contrary to federal income tax rules and the existing laws of virtually every other state with an income-based tax system. Enacting this proposal would double tax REITs and signal Hawaii's discouragement to long-term capital investment. This would potentially result in a reduction of millions of dollars of new REIT investment, a shift in property ownership to tax-exempt owners like pensions and endowments, and loss of revenue and significant jobs generated by REITs to the State. Accordingly, NAREIT respectfully asks this Committee to hold H.B. 1012.

REITs are a way for people- including Hawaii residents and others – to own professionally-managed, rental real estate. Created by Congress in 1960, REITs are corporations that combine the investment dollars of many investors to own and operate rental properties that may include apartments (like Douglas Emmett's Waena Apartments, which provides workforce housing); theme parks (like CNL Lifestyle Properties' Wet'n'Wild Hawaii); shopping centers (like General Growth Properties' Ala Moana Center and Washington Prime Group's Pearlridge Center); hotels (like American Assets Trust's Embassy Suites at Waikiki Beach Walk), healthcare facilities (like Healthcare Realty Trust's Hale Pawaa medical office building), offices, and storage facilities. There are about 20 Securities and Exchange Commission (SEC)-registered REITs that have invested about $4 billion (as of Dec. 31, 2015) in over 70 Hawaii properties (worth approximately $7.7 billion, based on the equity market capitalization of all equity REITs in the FTSE NAREIT All REITs Index as of December 31, 2015).

Unlike partnerships, LLCs or other C corporations, REITs are legally mandated to distribute all their taxable income to shareholders as dividends so their income is taxed once – at the shareholder level. In exchange for meeting this distribution requirement, federal law grants REITs a DPD. Like every other state with a corporate net income tax but New Hampshire, Hawaii follows federal law and allows a DPD. Thus, the income generated by REITs is reported by, and income taxes on such income are paid by, the shareholders of these companies to their state of residence. In fact, NAREIT's membership includes almost 200 public REITs and hundreds of REIT mutual funds invested in those REITs. Many of these REITs (and the funds that own these REITs) own **no properties** in Hawaii yet distribute millions of dollars in dividends – taxable by Hawaii – to thousands of Hawaii shareholders. Hawaii is able to tax these dividends even though the rental income underlying the dividends is earned in other states.

REITs benefit Hawaii by paying millions of dollars in taxes, creating jobs, and helping local communities. Noted Hawaii economist Dr. Paul Brewbaker conducted a 2015 study on behalf of NAREIT that concluded that "[i]n just the past year REITs were associated with more than 11,700 jobs representing labor earnings of nearly $500 million and $95 million in tax revenue in Hawaii." In fact, REITs –like other commercial property owners - pay millions of dollars in general excise taxes (GET), property taxes and conveyance taxes. By investing hundreds of millions of dollars in property upgrades, their tenants generate even more in GET revenue. For example, Taubman's International Market Place (which opened last summer) is expected to pay in this current year over $1 million in general excise tax and over $3 million in property taxes. Taubman also paid in total over $1.5 million

[1] NAREIT is the worldwide representative voice of real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets.

in local conveyance taxes. The development of the center resulted in employment of over an estimated 1,000 construction jobs, and after opening is expected to create 2,500 permanent jobs (including employment by tenants).

If H.B. 1012 were enacted, those REITs would be likely to modify their businesses to minimize double taxation and the anticipated Hawaii revenue, risking millions of dollars of capital investment and thousands of jobs. A new tax of 6.4% on net income in one state that does not exist in another state will encourage multi-state REITs to invest where the tax does not exist in order to maximize value to shareholders. The Department of Business, Economic Development and Tourism's (DBEDT) REIT study released in September 2016 specifically notes that its "estimates do not take into account how REITs would change their behavior if the DPD were repealed." For example, REITs may claim deductions or tax credits not currently claimed because currently, the DPD fully offsets their income. At the same time, multi-state REITs likely would shift investments among the 48 states where double taxation is absent, and tax-exempt investors like pensions and endowments would fill the vacuum left by their departure and invest in more Hawaii real estate – resulting in no additional tax revenue for Hawaii.

H.B. 1012 discourages investment in affordable housing. REITs with office buildings or retail properties in Hawaii currently are encouraged to build workforce housing so their tenants have places to live and shop. Limiting the DPD only to income from affordable housing lowers already low margins, discouraging further investment in affordable housing. Investors would view 15 years as permanent, and would shift capital to states without double taxation. In fact, we understand that at least one large REIT declined to invest in a sizable Hawaii project due to the mere threat of this legislation.

REITs are good for Hawaii: NAREIT urges this Committee to hold H.B. 1012. Even though H.B. 1012 purports to suspend the DPD temporarily (for 15 years) and exempt certain "affordable housing," its enactment would be viewed as repeal. Except for New Hampshire, every other state that imposes a corporate-level income tax allows the DPD for widely-held REITs. Accordingly, NAREIT urges this Committee to hold H.B. 1012.

To learn more about REITs in Hawaii, see NAREIT's www.theREITwayHawaii.com.

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CORRECTED VERSION
February 9, 2017

The Honorable Tom Brower, Chair
House Committee on Housing
State Capitol, Room 423
Honolulu, Hawaii 96813

RE: H.B. 1012, Relating to Real Estate Investment Trusts

HEARING: Thursday, February 9, 2017, at 9:00 a.m.

Aloha Chair Brower, Vice Chair Nakamura, and Members of the Committee.

I am Myoung Oh, Director of Government Affairs, here to testify on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 9,000 members. HAR **opposes** H.B. 1012 which disallows the dividends paid deduction for Real Estate Investment Trusts (REIT) for a period of 15 years.

In 1960, the United States Congress created REITs to allow all individuals the opportunity to invest in large-scale diversified portfolios of income producing real estate. REITs are tied to all aspects of the economy, and has a major impact on our state and encompasses a full range of real estate including affordable housing developments, health care facilities, office buildings, shopping centers and hotels.

These investments in Hawai'i generate taxes to the State, such as through the workers and jobs it creates (income tax), the General Excise Tax for rental income and property taxes for the counties.

Under this measure, it proposes to remove the income tax deduction for dividends from a REIT, thereby creating a double taxation of income. HAR has concerns that this will become a disincentive to invest in Hawai'i and negatively impact the economy through these investments in real estate. Some benefits of the REITS include renovation and redevelopment of Waikiki Beachwalk, Waikiki International Marketplace, and Moanalua Hillside Apartments.

H.B. 1012 will have a negative effect on Hawaii's investment climate and undermine the State's credibility as an attractive place to invest in new real estate projects.

Mahalo for the opportunity to testify.

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TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Disallow REIT Deduction for Dividends Paid

BILL NUMBER: HB 1012; SB 1228 (Identical)

INTRODUCED BY: HB by FUKUMOTO, BROWER, C. LEE, MCKELVEY, NISHIMOTO, OHNO, SAIKI, WOODSON; SB by KEITH-AGARAN, Espero, K. Kahele

EXECUTIVE SUMMARY: This bill would suspend for 15 years the dividends paid deduction that real estate investment trusts, or REITs, now enjoy. The numerous REITs who now own and manage Hawaii real estate would be taxed like any other corporation doing business in Hawaii.

BRIEF SUMMARY: Amends HRS section 235-2.3(b) to provide that section 857(b)(2)(B) (with respect to the dividends paid deduction for real estate investment trusts) shall not be operative for Hawaii income tax purposes, except that the deduction shall remain available for dividends generated from trust-owned housing that is affordable to households with incomes at or below two hundred per cent of the median family income, as determined by the United States Department of Housing and Urban Development.

Amends HRS section 235-71(d) to provide that for tax years beginning after December 31, 2017, no deduction for dividends paid shall be allowed for real estate investment trusts in the state.

EFFECTIVE DATE: Upon approval, applies to taxable years beginning after December 31, 2017. Repealed on December 31, 2032.

STAFF COMMENTS: Currently under federal and state income tax law, a real estate investment trust (REIT) is allowed a dividend paid deduction, unlike most other corporations, resulting in that dividend being taxed once, to the recipient, rather than to the paying corporation. The proposed measure would make that section of the IRC inoperative for Hawaii income tax purposes for tax years beginning after 12/31/15, meaning that REITs would be subject to double taxation similar to other corporations.

All state income tax systems in the United States, including ours, have a set of rules that are used to figure out which state has the primary right to tax income. For example, most tax systems say that rent from real property is sourced at the location of the property, so if a couple in Florida rents out a property they own on Maui they can expect to pay our GET and our net income tax on that rent. These sourcing rules, which do vary by state but are relatively consistent across state lines, are there to assure consistent and fair treatment between states.

Sourcing rules, however, can yield strange results. Here, there is a Hawaii Supreme Court case saying that when real property is sold on the installment basis under an “agreement of sale,” where the seller remains on title until the price is paid (although the buyer can live in the house), then the interest on the deferred payments is Hawaii source income and is subject to our net income tax and our GET. There is also a Hawaii Tax Appeal Court case holding that when the

seller instead finances the deal by taking a purchase money mortgage on the property, and does not remain on title, then the mortgage interest is sourced to the residence of the seller, who in that case did not live in Hawaii. In the second case the court applied the rule for income from intangibles such as interest, royalties, and dividends, which says that income is sourced to the residence of the recipient unless you can connect it with some active business that the recipient is conducting somewhere else.

Real estate investment trusts (REITs) are source shifters. For income tax purposes, they take in rent income, which is sourced to the location of the property being rented. They don't pay income tax on that income as long as they distribute the money to their shareholders as dividends. The dividend income of their shareholders, on the other hand, is generally sourced to the residence of the shareholders. So the income that the property states expected to tax is instead taxed in the states in which the shareholders live. And, to the extent that REIT shares are held by tax-exempt entities such as labor unions and retirement funds, passive income such as dividends may not be taxed at all. Source shifting is an issue specific to state taxation.

Apparently the evil sought to be addressed by the bill is that REITs are in Hawaii, but do not get taxed because of the deduction allowed for dividends paid, while many REIT owners who receive the dividend income are either outside of Hawaii and don't get taxed either because they are outside of Hawaii, or are exempt organizations that normally are not taxed on their dividend income. Normally we like to have our income tax law conform to the Internal Revenue Code to make it easier for people and companies to comply with it, but our legislature has departed from conformity when there's a good reason to do so (such as if it is costing us too much money). The issue is whether such a good reason exists here.

REITs do pay general excise and property taxes on rents received and property owned – as do the rest of us who are fortunate enough to have rental income or property to our name.

Digested 2/8/2017

Testimony of Paul H. Brewbaker, Ph.D., CBE
Principal, TZ Economics

before the House Committee on Housing
Hawaii State Legislature
on
H.B. 1012 RELATING TO REAL ESTATE INVESTMENT TRUSTS

Thursday, February 9, 2017

My name is Paul H. Brewbaker and I am a private economist and for twenty years was a member and Chair of the Hawaii Council on Revenues. For several decades I have also participated in various tax policy discussions with the Legislature.

I **strongly oppose** this proposal to doubly tax REIT net incomes in Hawaii. The rationale that supporters of this bill need economic protection does not make sense. Seriously? Doubly tax GGP or other REITs because they are partly-owned by foreign or out of state interests? These are the actual reasons some local developers give for protectionist legislation to benefit their personal financial interests, that people from outside Hawaii own real estate in Hawaii.

The fact that owners may be from somewhere else *is not a bad thing*. It's fake economics made up to scare you into thinking the aliens are taking over. That is not a thing. You and your pension fund own shares of companies, like REITs, in other places. So what.

In 2015 I was engaged as a consultant to the National Association of Real Estate Investment Trusts to study the economic impacts of REITs. Eventually my colleagues at DBEDT published their report. Here's what I found in mine.

Remember why REITs were created by the U.S. Congress 67 years ago, the year after Hawaii became a state. In those days, commercial and residential real estate in Hawaii and elsewhere was owned by a small number of wealthy individuals and their trusts. Everybody paid them rent. They ran the banks. Their kids went to private school together so that, later on, the next generation of landlords could own the real estate in Hawaii and everybody could pay rent to them. The Descendants. A landed, political autocracy in Hawaii served their personal interests. Then came Catch-A-Wave. 67 years ago, Congress created mutual funds for real estate through which individual investors, regular people, small investors, could own real estate, collectively, with other shareholders. Those mutual funds were called REITs. Congress created REITs as a financial pass-through for small investors to participate in real estate investment, *democratizing* real estate ownership. Competition among REITs assured, effectively, that 100 percent of these mutual funds' net incomes flowed to their investors. Forty-nine of the fifty states in America, for 67 years, remained committed to the principal that REIT net income should only be taxed *once*, in the form of dividend income accruing to individual shareholders.

As I wrote in my report, your Uncle's gas station in Waipahu, your Auntie's condominium in Kalihi, your cousin's retail building on Kalakaua could make them real estate investors. Or, with REITs, your Uncle could invest in Getty Realty, a REIT that owned an Aloha gas station in Waipahu, your Auntie could invest in Douglas Emmett, a REIT that owned Waena Apartments in Kalihi, and your cousin could invest in American Assets Trust, a REIT that owned The Shops at Kalakaua, making them real estate investors. They didn't have to be rich. They didn't have to be born into the right family. They didn't have to live in Abu Dhabi *and it doesn't matter if they do*. If they live in Hawaii, they pay taxes on the net income they earn as dividends from REITs or as landlords.

It's just a fact that REITs are responsible quantitatively for $2-3 billion of the construction associated qualitatively with many of the most transformative redevelopments in Hawaii during the current, investment-led phase of Hawaii's recent economic expansion. It's just a fact that most of these developments could not have been undertaken by local developers. It's also a fact that economic theory is clear about this principal: double-taxation of net income is a notorious economic policy fail. It distorts and allocation of capital and reduces social welfare. Unambiguously. It would raise the user cost of capital *but only for investors in Hawaii*. It would divert capital flows away from Hawaii to the other 48 states where double-taxation of REIT net income is absent. It's also a fact that, with the reputation Hawaii has for mistreatment of investors, passing this bill would have a deleterious "signaling" impact on Hawaii's reputation as an investment host.

DBEDT estimates that, for the same reasons that the corporate net income tax in Hawaii is widly procyclical—booming with economic upswings and crashing and burning with economic downturns—doubly-taxing REIT net incomes could have generated a burst of tax revenue, up to $35 million in one year, for about the five seconds the investment surge lasted, presumably through capital gains (they can't tell us and nobody knows). However, their estimating methodology is self-contradictory. DBEDT assumes that REITs are responsive to changes in the tax environment and its impacts on the user cost of capital, and yet in the hypothetical scenario in which Hawaii doubly taxes REITs, while 48 other states to which capital costlessly can flow do not, DBEDT assumes those REITs are completely *unresponsive* to changes in the tax environment. They can't be responsive *and* unresponsive. DBEDT's estimates cannot really be taken seriously.

At any rate, if it's "all about the money," I encourage the Legislature to stop looking at the individual trees to harvest for nickel and dimes in tax revenue, and consider that the entire forest is not growing the way some people are telling you it is. Tourism hasn't grown in the twenty-first century to date—real tourism receipts in 2016 were exactly the same as in 2000. Real, inflation-adjusted, Hawaii General Fund Revenue hasn't grown since sometime in the prior administration. Something deeper is at work, and bad economic policy that will *reduce* investment in Hawaii is not the solution. I recommend that H.B. 1012 be tabled.

Economic Impacts of Real Estate Investment Trusts in Hawaii

by Paul H. Brewbaker, Ph.D., CBE
TZ Economics
Kailua, Hawaii

December 2015

Prepared for the National Association of Real Estate Investment Trusts®
(NAREIT)

Executive Summary

- Real estate investment trusts (REITs) own and operate or finance income-producing commercial real estate such as shopping malls, apartment, office, and industrial buildings, hotels, senior housing, data centers, self-storage facilities, and theme parks. REITs distribute net income to shareholders as taxable dividends, fulfilling the intent of the U.S. Congress when in 1960 it enabled small investors to own property through REITs.

- More than 9,300 individual investors in Hawaii receive $30 million each year in public non-listed REIT distributions (one type of REIT). Hawaii-based advisers also are active REIT investors for clients, holding $32 million in REIT stocks and $60 million in just one company's REIT-dedicated mutual funds. Many Hawaii organizations manage employee retirement savings plans with REIT investments. (The Employer-Union Health Benefits Trust Fund (EUTF) owned a $79 million interest in a Vanguard REIT fund.) Combined, Hawaii residents own an estimated $2.5 billion in real estate equity through REITs, mutual funds, and exchange-traded funds. They receive more than $105 million in REIT dividends annually, on which $8.8 million in Hawaii state taxes are due.

- In just the past year REITs were associated with more than 11,700 jobs representing labor earnings of nearly $500 million and $95 million in tax revenue in Hawaii. In the past five years REIT-related construction activity is estimated to have generated $3 billion in Hawaii GDP. REIT investments have sustained tourism with more than 4,500 lodging units, and have provided more than 200,000 square feet of medical office space, 5.2 million square feet of retail space, and 12,400 self-storage units in Hawaii.

- Characteristics of REIT-related construction are as important as magnitudes. At Ala Moana Center, International Market Place, and elsewhere, transformative investments by REITs redefine the tourism destination experience and adapt to changing resident consumer preferences. Few individuals and only small numbers of corporate investors in Hawaii have capital markets access equivalent to what is enabled by REITs.

- A Hawaii legislative proposal to eliminate the dividends paid deduction (DPD) for REITs would subject Hawaii shareholders to double taxation, a notorious distortion in the economic theory of taxation that is not in the public interest. Double-taxing Hawaii REITs would reduce future construction and investment, risking capital flight to the 48 other states where double-taxation is absent. The investor groups most likely to replace REITs in Hawaii are tax-exempt institutions such as pension plans, foundations, and university endowments that, overall, would generate less in taxes from their real estate investments in Hawaii. Hawaii could lose more tax revenue from foregone economic activity in response to DPD elimination than would be gained in corporate income taxes, which comprise only 0.4 percent of State of Hawaii revenues. Eliminating the DPD for REITs would signal adversely Hawaii's investment climate and undermine the State's credibility as an investment host.

Overview

A. *The Real (Estate) World*

Suppose that your Uncle owns a gas station in Waipahu, or perhaps your Auntie owns a condominium in Kalihi; maybe your cousin owns a retail building on Kalakaua Avenue. Your Auntie, your Uncle, and your cousin are real estate investors. They collect rents from their tenants. They pay property taxes. They pay for improvements, and for maintenance and other expenses. They pay income taxes on the net income they earn.

Now, instead, let's say that your Uncle invested in Getty Realty, a REIT that owns an Aloha gas station in Waipahu. Instead of buying an apartment, your Auntie invested in Douglas Emmett, a REIT that owns Waena Apartments in Kalihi. Instead of buying that retail building on Kalakaua, your cousin invested in American Assets Trust, a REIT that owns The Shops at Kalakaua. Those REITs would collect the same rents from the same tenants. They would pay the same property taxes, and would pay for the same improvements and maintenance and other operating expenses. Then—by law—these REITs would distribute at least 90 percent (but probably 100 percent; possibly more) of the same net income to your Uncle, to your Auntie, and to your cousin, income subject to the same income taxes.[1]

What about the most valuable properties in Hawaii, such as Ala Moana Center? Only the wealthiest people can afford to own, outright, properties like Ala Moana, but because Ala Moana is owned by a REIT, Uncle, Auntie, or cousin still can receive their share of the net income that Ala Moana produces, and pay taxes on that income, by investing in that REIT. They can also place their savings with Hawaii institutional investors that own REITs on their behalf, funding Uncle, Auntie, and cousin's benefit plans and retirement plans. [2]

B. *Introduction*

REITs are a financial structure established by Congress in 1960 to expand access to real estate investment for small investors, similar to stock mutual funds. Corporations retain earnings and many corporations pay no dividends, relying on capital gains to reward investors. For these

[1] Uncle, Auntie, and cousin would have secured their own retirement, too. Over the past 20 years, Getty Realty's investments have produced total returns averaging 9.5 percent per year, significantly better than the S&P 500 stock index. Over the past 10 years, Douglas Emmett investments produced total returns averaging 15.3 percent per year—again better than the S&P 500. American Assets Trust, since January 2011, has returns averaging 18.6 percent per year—nearly two-thirds better than the S&P 500. REITs pool incomes from commercial real estate across the country, hedging geographic risk, and earn risk-adjusted returns generally in excess of those of stocks.

[2] Information available from published sources (such as S&P Money Market Directory and Preqin databases) indicate that Hawaii-based institutional investors such as the University of Hawaii 403(b) Plan, the Hawaiian Airlines Pension Master Trust Hawaii Pacific Health Savings Plan, Kamehameha Schools, the Hawaii Employer-Union Health Benefits Trust Fund (EUTF), Queen's Health Systems (Pension Plan, Land Company Endowment Fund, and Retirement Plus Plan), Hawaii Community Foundation, Office of Hawaiian Affairs, and City & County of Honolulu 457 Deferred Compensation Plan, all invest broadly in REITs.

reasons corporations are taxed separately from their shareholders. In contrast, REITs are strictly regulated in a manner that results in distribution of essentially all net income through dividends to shareholders, or through dividend reinvestment programs, taxable as dividend income. REITs facilitate capital inflows to the Hawaii economy as well as capital outflows from the Hawaii economy, as investors in and out of Hawaii invest in real estate inside and outside Hawaii.

Investment *is* capital formation: it expands Hawaii's productive capacity and creates jobs regardless of who the investors are or where they are from. Hawaii investors are no different from Chinese or U.S. mainland investors or those from Botswana. Investors in Hawaii REITs earn dividend income that is no different from the dividend income paid to Hawaii investors in REITs, including to Hawaii investors in Hawaii REITs. Internal Revenue Service (IRS) data show that, in 2013, thousands of Hawaii residents directly and indirectly (through pension funds and other investments) own approximately $1 billion worth of REIT shares, and that Hawaii collects at least $8.8 million in individual income taxes from Hawaii REIT shareholders.

Concern has been expressed that, perhaps, the State of Hawaii should tax REITs the way it taxes other corporations, even though REITs pay out all their net income as a financial pass-through while corporations do not.[3] A second conjecture hypothesizes that taxing Hawaii REITs like such corporations—doubly-taxing first the financial vehicle and then taxing its Hawaii owners again, on the same income—might be a lucrative State revenue source.

First, double-taxing capital income is a notorious distortion in the economic theory of taxation, about the worst tax idea ever. Double-taxing REITs could drive their investments in Hawaii down significantly, towards net *dis*investment from Hawaii. Disinvestment would reduce productivity and income in Hawaii. Many of the investor groups likely to replace REITs in Hawaii under such a circumstance are tax-exempt institutions such as pension plans, foundations, and university endowments that would generate neither corporate nor the same individual income taxes from their real estate investments in Hawaii. Other non-REIT investors already could have done what REITs have done, or could have paid more to acquire REIT investments: REIT disinvestment in Hawaii would be tantamount to an asset price deflation in Hawaii.

Second, it is unlikely that double-taxing REIT net incomes in Hawaii would yield material Hawaii corporate tax revenue. REITs can leave Hawaii and the dynamic effect of doubly-taxing them would be exit: a tax on nothing is nothing. Considering the trivial amounts of tax revenue Hawaii actually receives from *all* corporations doing business in Hawaii,[4]

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[3] See Tom Yamachika, President, Tax Foundation of Hawaii (August 31, 2014), "REITs: A New [*sic*] Kind of Tax Shelter?" *Hawaii Free Press* (http://www.hawaiifreepress.com/ArticlesMain/tabid/56/ID/13398/REIT-ndash-A-New-Kind-of-Tax-Shelter.aspx).

[4] FY2015 Hawaii corporate income tax revenue (CIT) declined 39.9 percent to $52.3 million, from $87.0 million in FY 2014, which was "down 13.9 percent from the previous year's total of $101.0 million" (Hawaii Department of Taxation *2013-2014 Annual Report* (http://files.hawaii.gov/tax/stats/stats/annual/14annrpt.pdf) and fiscal 2015 year-end data (http://files.hawaii.gov/tax/stats/monthly/2015-fis_rev.zip). On trend, measured in constant 2014 dollars to adjust for inflation, Hawaii's CIT declined from $110 million in 1969 to $66 million in 2014 and—on trend—would continue declining to $62 million by 2020. In some quarters corporate tax receipts are negative—sometimes the State pays corporations. Corporate tax collections are cyclical but small, comprising only 0.9 percent of Hawaii

amounts which have declined steadily for 45 years, it's not clear why a corporate tax is even interesting. Hawaii would risk losing more revenue than Hawaii would gain by doubly-taxing REITs, once its substantial negative impact on capital formation in Hawaii is taking into account.[5] Such a barrier to REIT investment is a state tax impediment found in only *one* other state (New Hampshire).

Using the State of Hawaii's input-output model to estimate economic impacts, in just the past year Hawaii REITs have been associated with more than 11,000 construction and non-construction jobs, together representing labor earnings of $482 million, generating more than $95 million in state taxes. REIT investments have sustained Hawaii's principle export, tourism, by providing more than 4,500 lodging units, and in other Hawaii commercial real estate have provided more than 200,000 square feet of medical office property space, 5.2 million square feet of retail space, and 12,400 self-storage units.

DISCUSSION

The discussion below is organized as follows. First, the study provides background on REITs generally, what they are and who invests in them. Second, the study attempts to elucidate who in Hawaii invests in REITs and in Hawaii REITs. Third, the study evaluates some economic impacts of REITs in Hawaii specifically, in investment and redevelopment. Fourth, the study elaborates on why elimination of the so-called REIT dividends paid deduction (DPD) could be a tax policy mistake: economically inefficient and ineffective at revenue-raising, it could risk a net loss of Hawaii tax revenues as a result of its adverse dynamic effects on investment.

I. Background on Real Estate Investment Trusts (REITs)

A. *REITs enable average investors to own commercial real estate*

REITs are companies that own and operate or finance commercial-grade, income-producing real estate like shopping malls, apartment, office, and industrial buildings, hotels, senior housing, data centers, self-storage facilities, and theme parks, even commercial timber forests. REITs distribute that income after expenses to shareholders as taxable dividends. While in the past, only very wealthy individuals could own commercial real estate, in 1960 the United States Congress enacted tax legislation creating REITs to enable all investors to own this type of property through REITs.

General Fund Revenues in FY2015. Hawaii CIT was as low $8.3 million in 2003 ($7.2 million in 2014 dollars), less than what Hawaii shareholders of REITs pay annually in individual income taxes on their REIT dividends. See http://files.hawaii.gov/tax/stats/stats/annual/03annrpt-rev.pdf, and IRS *Statistics of Income* data, at: https://www.irs.gov/uac/SOI-Tax-Stats-Historic-Table-2.

[5] Of course, Hawaii REIT shareholders would continue earning dividend income on which taxes would be paid.

Patterned after mutual funds of stocks and bonds,[6] REIT shareholders own shares of pools of real estate assets. Equity REITs own commercial properties like shopping malls, office buildings, apartments, and even cell phone towers from which rents and/or gains from occasional property dispositions are collected and distributed after expenses to shareholders through dividends. Mortgage REITs invest in mortgages or mortgage-backed securities, distributing income after funding costs to shareholders through dividends. Although the tax code requires REITs to distribute at least 90% of their taxable income, in practice market preferences assure that virtually all net incomes are distributed to shareholders as dividends. Public equity REITs and mortgage REITs often are traded on stock exchanges like the New York Stock Exchange (NYSE) and are registered with the Securities and Exchange Commission (SEC). Some public REITs are not listed on exchanges but are sold directly to investors by brokers and also are registered with the SEC. Other REITs are privately-held and are neither exchange-traded nor SEC-registered.

B. *REITs have provided portfolio diversification and an inflation hedge*

For the investor, REITs have provided an additional avenue for portfolio diversification in a format that enables real estate to be held in small shares rather than in lumpy, whole properties. Research typically has shown that adding real estate to portfolios of stocks and bonds by investing through REITs has increased risk-adjusted returns: yields have risen and volatility has declined.[7] Real estate returns have exceeded inflation rates, providing a natural inflation hedge. REITs have been shown over long periods of time systematically to outperform both stocks and corporate bonds while delivering more stable income streams. REIT ownership has proven to be a well-established method of improving overall portfolio performance relative to portfolios that only hold stocks and bonds.

C. *Unlike other businesses, REITs must satisfy requirements ensuring that they are long-term investors in real estate*

Unlike other non-REIT business entities, REITs must comply with a burdensome set of requirements to ensure that they are widely-held, long-term investors in real estate or real estate financings.

Specifically, unlike other business entities, the federal tax code (and those state tax codes, like Hawaii's, that conform to this code) provides that a REIT: (a) must maintain at least 75

[6] For additional background regarding mutual funds and how they operate, *see* Appendix A:How U.S. Regulated Investment Companies Operate and the Core Principles Underlying Their Regulations (2015, Investment Company Institute) (available at: http://www.icifactbook.org/fb_appa.html)

[7] See, for example, https://www.reit.com/sites/default/files/media/PDFs/Research/2015ResearchConferenceBoudry.pdf; https://www.reit.com/sites/default/files/portals/0/PDF/CohenSteersReport.pdf; https://www.reit.com/data-research/research/cem-benchmarking-defined-benefit-pension-fund-research-sponsored-nareit; https://www.reit.com/data-research/research/wilshire-research-optimizing-target-date-fund-performance-reits.

percent of its assets in qualifying real estate assets; (b) must receive 75% of its income from some combination of rent from real property, interest from mortgages secured by real property and gains from the sale of real property, or other delineated real estate sources; (c) must receive 95% of its income from the aforementioned qualified real estate sources and from other passive sources;[8] and (d) must have more than 100 shareholders with no fewer than five individuals owning more than 50 percent of its stock.[9] Furthermore, in order to ensure that REITs are long-term investors in real estate, REITs are subject to a potentially confiscatory tax faced by no other non-REIT business entities: a full 100 percent tax on any gain from the disposition of an asset held primarily for sale.[10]

D. *Unlike other businesses, REITs must distribute all of their income as taxable dividends; their shareholders pay tax on these dividends*

In addition to the above requirements, and like mutual funds of stocks and bonds, the corporate income tax liability on REITs' income is borne by shareholders to the extent that the REIT distributes its taxable income to its shareholders. REITs calculate their taxable income and, like mutual funds, can deduct from their taxable income all dividends paid to their shareholders (through the dividends paid deduction). As mentioned above, REITs typically distribute all of their taxable income to shareholders. In 2014, Securities and Exchange Commission (SEC)-registered REITs distributed $46 billion to shareholders.[11] REIT shareholders are subject to tax on the dividends, primarily at the highest ordinary income rate, not the lower qualified dividend rate.[12] Notably, unlike pass-through entities, which today account for a vast majority of commercial real estate investment in the United States, REITs generally are not permitted to pass through tax losses or tax credits to their shareholders.

From a state income tax perspective, a state collects taxes on REIT dividends regardless of where the REIT owns properties. Thus, REIT shareholders who are Hawaii residents pay individual income taxes in Hawaii even if (as is true in the majority of cases) the REIT does no business in and owns no properties in Hawaii. This single taxation regime contrasts with the zero taxes collected in Hawaii from tax-exempt institutions such as pension plans, foundations

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[8] As a result of this 95 percent rule, REITs are unlike other business entities and can only earn up to 5 percent of their annual gross income from non-qualifying sources like real estate services to non-tenants.

[9] Internal Revenue Code (IRC) §§ 856(a), (c)(2) and (c)(3).

[10] IRC §857(a)(6).

[11] "REIT Industry Financial Snapshot" (as of 9/30/15) , published by the National Association of Real Estate Investment Trusts® (NAREIT)) (available at: https://www.reit.com/data-research/data/industry-snapshot). In particular, "[s]tock exchange-listed REITs paid out approximately $42 billion and public non-listed REITs paid out approximately $4 billion in dividends during 2014." *Id*.

[12] "2014 Year-End Summary" (NAREIT) (available at: https://www.reit.com/data-research/data/year-end-tax-reporting-data/2014/2014-year-end-summary.

and university endowments.[13] This distinction between single tax and zero tax outcomes is important because tax-exempt institutions are very significant investors in commercial real estate and would be the most likely replacement investors if REITs decide to invest in the other states that do not impose a double layer of taxes.

E. *All states with an income-based corporate income tax (except one) follow the federal taxation of REITs and their shareholders*

Today, every state except for New Hampshire that imposes a corporate net income tax conforms to federal income tax rules and allows widely-held and/or publicly traded REITs (and mutual funds) to deduct their dividends paid to shareholders. Although a state in which a REIT owns property might not collect income taxes from REIT shareholders outside of that state, the state does collect income taxes from all its residents who own REIT shares, even on income from properties located outside of that state.

II. Hawaii investors in REITs and Hawaii REITs

A basic question about REITs in Hawaii is who in Hawaii invests in REITS, and who in Hawaii invests in Hawaii REITs? Because portfolio preferences are a fluid matter of changing asset allocation for most investors, even for the half of Hawaii households who are homeowner-occupants, any question about who owns what is naturally challenging to answer. This section of the study details what is available primarily through securities and tax filings. Even then, most of what might be known can only be inferred, and some of what is discussed below is offered without drawing explicit inferences, though the information may be suggestive to readers.

A. *Hawaii investors in REITs and in Hawaii REITs*

1. *Publicly traded REITs: "Shares Held in Street Name"*

Stock-exchange (*e.g.*, the New York Stock Exchange or NASDAQ) listed REITs generally are not able to identify the total number of Hawaii taxpayers who are direct investors in that REIT and the amount of dividends paid to those investors. Like all publicly traded companies, the overwhelming majority of stock exchange-traded REIT shares are held in "street name" by a nominee who is not obligated to report the underlying shareholder-identifying information to the REIT. In fact, for most companies, the registered shareholder that owns the

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[13] For example, a recent article cites Prequin, the leading source of information for private real estate investment, that the *average* commercial real estate for a public pension fund, a private pension fund and an endowment is $758 million, $434 million and $143 million, respectively. *See* http://nreionline.com/institutional-investors/pension-funds-endowments-hunger-real-estate-assets. Further, the article indicates that the real estate allocations for all three groups are below their target goals.

majority of their stock is a company called DTC (Depositary Trust & Clearing Corporation) and, more specifically, its affiliated company, "Cede & Co."[14]

Even to the extent that the actual shareholder names are available, many shareholders in stock exchange traded REITs are institutional investors such as mutual funds and pension/health benefit funds. These companies do not provide shareholder-level identifying information.[15]

There are certain public securities filings that are required of shareholders who own more than 5 percent of a publicly traded company.[16] However, these shareholders tend to be large institutional investors such as mutual funds which, like REITs, have pooled the capital of many investors to invest in their underlying portfolio of assets. In fact, mutual funds tend to own a significant percentage of stock in publicly traded REITs[17] and, in most, if not all cases, these REITs are unable to identify the ultimate mutual fund beneficiaries.[18]

Additionally, the Investment Advisers Act of 1940[19] requires advisers that have at least $100 million of assets under management or advise a registered investment company to register with the SEC and periodically report their stock and securities ownership. Such advisers include Bank of Hawaii and First Hawaiian Bank. These advisers must file a Form 13F with the SEC listing their securities ownership. However, it is not possible to know whether the securities listed on these forms are owned directly by such money managers or on behalf of their underlying clients.

2. *Available data*

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[14] *See* http://www.dtcc.com/asset-services/issuer-services/how-issuers-work-with-dtc.aspx ("When an investor holds shares this way, the investor's name is listed on its brokerage firm's books as the beneficial owner of the shares. The brokerage firm's name is listed in DTC's ownership records. DTC's nominee name (Cede & Co.) is listed as the registered owner on the records of the issuer maintained by its transfer agent. DTC holds legal title to the securities and the ultimate investor is the beneficial owner.")

[15] In fact, both the DBEDT and Department of Taxation (DOTAX) testimony with respect to an earlier version of recently proposed legislation, S.B. 118, S.D. 1, noted that many mutual funds invest in REITs. *See* "Statement of Luis P. Salaveria," Director, Department of Business, Economic Development, and Tourism, before the House Committee on Consumer Protection and Commerce and Committee on Judiciary in consideration of SB118, SD1 (March 18, 2015), available at http://www.capitol.hawaii.gov/Session2015/Testimony/SB118_SD1_TESTIMONY_CPC-JUD_03-18-15_.PDF and "Statement of Maria E. Zielinski", Director, Department of Taxation, before the House Committee on Consumer Protection and Commerce and Committee on Judiciary in consideration of SB118, SD1 (March 18, 2015), available at http://www.capitol.hawaii.gov/Session2015/Testimony/SB118_SD1_TESTIMONY_CPC-JUD_03-18-15_.PDF.

[16] *See "Laws that Govern the Securities Industry"* http://www.sec.gov/about/laws.shtml.

[17] For a list of dedicated REIT funds, *see* https://www.reit.com/investing/investing-reits/list-reit-funds.

[18] DOTAX specifically noted that "a mutual fund cannot be compelled to provide information on the number of Hawaii taxpayers investing in such fund or the amount of income attributable to a REIT operating in Hawaii. Therefore any report will not be able to provide all of the information as requested in this measure." *See* footnote 20 (citing testimony).

[19] http://www.sec.gov/about/laws.shtml#invadvact1940.

REITs are just as popular an investment vehicle choice of Hawaii individuals and institutions as they are nationwide. Many Hawaii investment managers include significant REIT holdings in their client portfolios. Again, while data limitations preclude a complete accounting, a picture of the scope of Hawaii REIT investors, investment managers, and their holdings can be sketched.

(*a*) Public, non-listed REITs

Public, non-listed REITs (PNLRs) are REITs that are required under federal securities laws to file periodic reports with the SEC, because of their asset size or large shareholder base, but are not listed on a stock exchange. While shareholder-level data regarding exchange-traded REITs is difficult to obtain, shareholder-level data from PNLRs is available from DST Systems, the transfer agent for many of these companies.

DST data disclose that more than 9,300 individual investors in Hawaii received a total of nearly $30 million in PNLR distributions during 2014, the last full year for which data are available. Sixty percent of these distributions for Hawaii investors comprised cash distributions; the other forty percent were in dividend reinvestment programs pursuant to which shareholders acquire additional shares in lieu of receiving cash distributions. Shareholders still must pay tax on the value of the distribution used to reinvest in new shares. While this is not an exhaustive characterization, it is instructive of the significant magnitudes of REIT distributions accruing to Hawaii residents.[20]

(*b*) Hawaii-based investment advisers and institutional investors

Hawaii-based advisers also are active REIT investors on behalf of their clients. Public data in SEC filings can be gathered for a number of major local banking names like Bank of Hawaii[21] and First Hawaiian Bank,[22] among others, along with smaller providers of investment advisory services[23] to get a feel for how important REIT investments are in locally-managed portfolios. This data show that these Hawaii institutions held approximately $32 million in REIT stocks reported as owned as of June 30, 2015.

[20] Data provided by DST Systems, the transfer agent for most public, non-listed REITs.

[21] Bank of Hawaii, Form 13F-HR (quarter ended 6/30/15); *see* http://www.sec.gov/Archives/edgar/data/315080/000031508015000005/xslForm13F_X01/primary_doc.xml *and* http://www.sec.gov/Archives/edgar/data/315080/000031508015000005/xslForm13F_X01/2015_2Q_INFO_FILE.XML.

[22] First Hawaiian Bank, Form 13F-HR(quarter ended 6/30/15) *see* http://www.sec.gov/Archives/edgar/data/315080/000031508015000005/0000315080-15-000005-index.htm and http://www.sec.gov/Archives/edgar/data/764106/000076410615000005/xslForm13F_X01/062015.xml.

[23] *See, e.g.,* C.M Bidwell & Associates Ltd, Form 13F-HR (quarter ended 3/31/15) (http://www.sec.gov/Archives/edgar/data/1091860/000109186015000005/xslForm13F_X01/primary_doc.xml *and* http://www.sec.gov/Archives/edgar/data/1091860/000109186015000005/xslForm13F_X01/cmba13f-hr033115.xml) and Cadinha & Co LLC, Form 13F-HR (quarter ended 6/30/15) http://www.secinfo.com/dS5q2.mb.d.htm#1stPage (showing approximately $13 million owned in Weyerhaeuser, a timberland REIT with no Hawaii properties).

Another potential source of dividend and capital gain income for Hawaii investors are the REIT-dedicated mutual funds or exchange-traded funds,[24] including those sponsored by Vanguard, Cohen & Steers, and Wilshire. In fact, thousands of Hawaii shareholders have invested about $60 million in several dedicated REIT mutual funds sponsored by a single mutual fund company.[25] The State is collecting taxes on the millions of dollars distributed to Hawaii investors by these companies and funds that invest in REITs, even though almost all of the properties held by these REITs are located outside of Hawaii.

(*c*) Hawaii public officials

In addition to REIT shares owned outright or through brokerage firms, investment advisers, mutual funds, pension funds and other retirement savings investment vehicles, or insurance companies, public record data associated with ethics filings and other public disclosures indicates a pattern of REIT ownership that can be associated with many dedicated public servants as well as individuals outside government serving on boards and commissions. Without disclosing individuals' personal information, it still can be asserted that it is commonplace for a number of distinguished Hawaii political leaders, persons in senior management positions in State and County government, and members of public boards and commissions to hold REIT investments in their personal or managed investment portfolios.[26] Their investment preferences are, as a generalization, not different from those of the public at large, or from those of beneficiaries or managers of Hawaii's public pension system or of public union health trust funds.

(*d*) Hawaii residents—UPREITs

As noted in Appendix I, many of the more than 200 stock-exchange traded REITs are organized in the UPREIT form. Limited partners who own partnership shares in REIT operating partnerships earn income from the partnership's activities and are liable for federal and state income taxes on this income (as appropriate). While publicly available information regarding UPREIT limited partners is itself limited to relatively large owners, it does indicate that three Hawaii individuals own millions of partnership units in Pacific Office Properties Trust, which is headquartered in Hawaii.[27]

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[24] For a list of such funds, *see* https://www.reit.com/investing/investing-reits/list-reit-funds.

[25] This information is not generally available, but was provided to NAREIT by the mutual fund company. In 2014 their accounts received income and capital gain distributions totaling $8.5 million.

[26] Financial disclosure information is obtained from the Hawaii State Ethics Commission and republished at http://www.civilbeat.com/disclosures/.

[27] NOTICE OF ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON MAY 28, 2015, PACIFIC OFFICE PROPERTIES TRUST, INC., p. 10 available at: http://www.pacificofficeproperties.com/PDFGovernance/2015%20Proxy%20Statement.pdf. Note that two of these individuals also own hundreds of thousands of limited partnership units in another REIT"s (Corporate Office Properties Trust's) operating partnership, Corporate Office Properties L.P.; Exhibit 1, Schedule of Partners, Corporate Office Properties Trust and Corporate Office Properties, L.P., Form 8-K (April 15, 2015), available at: http://markets.on.nytimes.com/research/stocks/fundamentals/drawFiling.asp?docKey=137-000086054615000014-

(*e*) Hawaii retirement and health benefit foundations: ownership in REITs and in REIT-dedicated mutual funds

Many significant Hawaii organizations which manage retirement savings plans on behalf of their employees are REIT investors, or include REIT fund options in their employee retirement-savings plans, such as Hawaii Pacific Health, Hawaiian Airlines, The Queen's Health System, University of Hawaii Foundation, Hawaiʻi Community Foundation, Office of Hawaiian Affairs, City & County of Honolulu, and Kamehameha Schools.[28]

In particular, the Employer-Union Health Benefits Trust Fund (EUTF), which provides a variety of medical and life insurance benefits to almost 200,000 Hawaii state and local current and former employees, owned a $79 million interest in a Vanguard REIT fund.[29]

(*f*) Data from stock exchange-traded REITs

Even with the limitation on identifying Hawaii-resident shareholders because of the "street name" issue noted above, a number of exchange-traded REITs were able to provide proprietary data obtained from an outside vendor that provides proxy solicitation services to them. Proxies are sent to shareholders of record who have voting control over specific shares. Thus, the information can be used as an estimate for the actual market value of shares that might be owned by these shareholders (as voting control may, but does not necessarily, correlate to value). Even with a relatively small sample size, the data show that at least hundreds of Hawaii "accounts" have voting control over hundreds of thousands of shares of REITs with Hawaii properties.

(*g*) Internal Revenue Service data and additional estimates

Recent IRS aggregate data[30] concerning individual income tax returns (Form 1040) shows that more than $700 million in total "ordinary dividends" (both "qualified dividends,"

2MON4B44IRJQV17J3M3RLCJJ76&docFormat=HTM&formType=8-K. While this REIT owns no Hawaii properties, both partners presumably may earn income taxable in Hawaii through this interest.

[28] S&P Money Market Directory and Preqin databases.

[29] Based on this link, http://files.hawaii.gov/auditor/Reports/2014_Audit/EUTF2014.pdf, that fund is the "Vanguard REIT Index Fund." The fund invests in publicly traded REITs and, as of September 30, 2015, its net assets were valued at $48 billion. Notice that the Vanguard REIT Index Fund's holdings as of September 30, 2015 include REITs listed below with portfolios including Hawaii properties. Their value at this time also is reported below. Simon Property Group (Waikele Outlets) and Public Storage (various self-storage facilities) make up 12.8 percent of the fund's net assets. As a result, a large percentage of the Vanguard REIT Index Fund's dividend supports health and welfare benefits of current and prior Hawaii employees, including: Simon Property Group (about $4 billion) (8.3 percent of fund); Public Storage (about $2.1 billion) (4.5 percent of fund); General Growth Properties (about $1 billion); Host Hotels & Resorts (about $800 million); Extra Space Storage (about $600 million); Healthcare Trust of America (about $200,000); Sunstone Hotel Investors (about $200,000); Healthcare Realty Trust (about $200,000); WP Glimcher Inc. (about $150,000); Xenia Hotels & Resorts (about $129.000); American Assets Trust (about $93,000); Select Income REIT (about $88,000); and Getty Realty Corp (about $29,000).

taxed at the lower tax capital gains tax rate for federal purposes of up to 23.8 percent, and "non-qualified dividends," taxed at the higher federal tax rate applicable to ordinary income of up to 43.4 percent) and approximately $500 million in qualified dividends, were reported by Hawaii taxpayers for the 2013 tax year. While the IRS data does not provide any detail regarding the percentage of these dividends comprising REIT dividends, it is clear that most REIT dividends are considered "non-qualified" dividends.[31] Further, like some mutual fund dividends, some REIT dividends are considered capital gain dividends (reported as net capital gain, rather than as dividends).[32]

Many companies—including real estate companies that choose not to adhere to REIT rules—make small distributions or make no distributions as dividends to their shareholders. Instead, these companies elect to use the cash generated by their operations to make acquisitions or to pay for other strategic initiatives. In some cases, companies are successful in driving up their share prices, but investors pay no taxes on dividends (because the companies pay no dividends), and investors also incur no capital gains tax liability until they sell their appreciated shares. In other cases, company strategies are unsuccessful and the retained cash is shifted to bad investments, resulting in no taxes paid on either dividends or capital gains. REITs, however, must distribute all of their taxable income each calendar year in the form of dividends to shareholders, who pay tax on those dividends—which means that REITs do not have the same opportunity that other companies have to shelter cash from taxation, whether by creating unrealized capital gains (on which taxes are deferred until the gains are realized) or by making bad investments (in which case no taxes are due).

SEC-registered REITs paid over $46 billion in aggregate distributions during 2014[33]. The share paid directly and indirectly to Hawaii residents—and therefore subject to Hawaii personal income taxes—is difficult to determine, but Hawaii appears to benefit more than other states from REIT dividend payments:

- According to the U.S. Census Bureau[34], Hawaii has more residents aged 56 and older compared to other states (data from 2010):
    - Age 56-60: 6.9% of Hawaii's population, 6.4% of the rest of the U.S.
    - Age 61-65: 6.0% of Hawaii's population, 5.4% of the rest of the U.S.
    - Age 66-70: 4.3% of Hawaii's population, 4.0% of the rest of the U.S.
    - Age 71-75: 3.04% of Hawaii's population, 3.00% of the rest of the U.S.

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[30] Available at https://www.irs.gov/pub/irs-soi/13in12hi.xls, at https://www.irs.gov/uac/SOI-Tax-Stats-Historic-Table-2 .

[31] *See* "Year-End Tax Reporting Data" published by the National Association of Real Estate Investment Trusts https://www.reit.com/data-research/data/year-end-tax-reporting-data.

[32] *Id.* Again, the IRS data does not provide a breakdown of the portion of any capital gain comprised of REIT or mutual fund capital gain dividends.

[33] Source: SNL Financial.
[34] See http://factfinder.census.gov/faces/nav/jsf/pages/community_facts.xhtml.

- Age 76+: 7.0% of Hawaii's population, 6.0% of the rest of the U.S.

- According to the Survey of Consumer Finances conducted by the Federal Reserve Board of Governors[35], people in older age ranges are more likely than younger people to hold financial assets, and also have larger average financial asset balances (data from 2013):

    - Ages <35: 92.6% have financial assets; average balances were $38,270
    - Ages 35-44: 93.1% and $148,790
    - Ages 45-54: 93.3% and $251,020
    - Ages 55-64: 95.7% and $411,600
    - Ages 65-74: 97.4% and $563,160
    - Ages 75+: 97.2% and $302,210

- Because REITs provide sizeable and stable income payments, they appeal especially to older investors who are over-represented in Hawaii's population. While data are not available to show this among investors in exchange-traded REITs, data compiled by the much smaller number of public REITs that are not traded on exchanges[36] show that people in older age ranges are more likely to invest in REITs compared to younger people:

    - Ages <35: 0.01% of all Americans have shares in public non-traded REITs
    - Ages 35-44: 0.12% of all Americans have shares in public non-traded REITs
    - Ages 45-54: 0.27% of all Americans have shares in public non-traded REITs
    - Ages 55-64: 0.67% of all Americans have shares in public non-traded REITs
    - Ages 65-74: 0.98% of all Americans have shares in public non-traded REITs
    - Ages 75+: 0.49% of all Americans have shares in public non-traded REITs

- Hawaii residents in every age range are more likely to hold shares in public non-traded REITs compared to Americans who don't live in Hawaii, a fact that may hold true for exchange-traded REITs as well:

    - Ages <35: 0.03% of Hawaii residents compared to 0.01% of other Americans
    - Ages 35-44: 0.24% of Hawaii residents compared to 0.12% of other Americans
    - Ages 45-54: 0.48% of Hawaii residents compared to 0.27% of other Americans
    - Ages 55-64: 1.00% of Hawaii residents compared to 0.67% of other Americans
    - Ages 65-74: 1.56% of Hawaii residents compared to 0.97% of other Americans
    - Ages 75+: 0.62% of Hawaii residents compared to 0.48% of other Americans

The democratization of real estate investing intended by Congress in the enabling legislation for REITs means that even the smallest individual investors can own REIT shares directly: according to data compiled by Citi Research, 17.5 percent of REIT shares are owned directly by individuals (not including REIT executives or other insiders), representing ownership of real estate equity valued at $154 billion. If Hawaii residents owned only their proportionate

[35] Available at: http://www.federalreserve.gov/econresdata/scf/scfindex.htm.

[36] Data provided by DST Systems.

share, they would have direct REIT holdings worth about $742 million, but the age distribution of Hawaii's population means that they probably own more.

Many other investors own shares in mutual funds and exchange-traded funds (ETFs) that invest exclusively or invest primarily in REITs. Citi Research estimates that such funds own 24.5 percent of REIT shares, with a total value of about $215 billion; [37] Hawaii's proportionate share would be $1.04 billion and its actual share probably is even larger than that.

Many investors own shares in mutual funds and ETFs that cover broader asset groups (such as the Vanguard US Total Stock Market Fund). Citi Research estimates that such funds own about 16.5 percent of REIT shares, with a total value of about $145 billion; Hawaii's proportionate share would be about $700 million and its actual share is likely greater.

Adding up those ways of investing in REITs suggests that individual Hawaii residents own a total of at least $2.5 billion in real estate equity by investing in REITs, either directly or through mutual funds and ETFs. With the average annual REIT dividend yield at 4.25 percent, that suggests that Hawaii residents receive—and pay taxes on—more than $105 million in REIT dividend payments each year through their individual and fund holdings.

As noted above, SEC-registered REITs paid over $46 billion in distributions during 2014, not only to individuals but also to certain institutional investors. Hawaii's proportionate share—both directly to individual investors and indirectly through mutual funds, pension funds, and other collective investments—would be about $224 million, but it is likely quite a bit more given Hawaii's age distribution and Hawaii residents' preference for REITs over other investments.

Moreover, many of the dividends paid by non-REITs represent qualified dividend income, and are therefore subject to a lower federal tax rate than ordinary dividends. According to the Internal Revenue Service, 42 percent of dividends reported by Hawaii residents in 2011 were qualified dividends subject to the lower tax rate. Most REIT dividends, however, are considered ordinary dividend income.

Using IRS data, Hawaii should be expected to collect about $8.8 million annually in income taxes from REIT dividends. The taxes collected by Hawaii from REIT investment incomes are probably higher as estimate does not include UPREIT partnership unit income or REIT capital gain distributions.[38]

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[37] "REITs For Sale: A Deep Dive Look At REIT Ownership and Recent Trends," Citi Research (11 September 2015).

[38] This estimate is calculated as follows. IRS Statistics of Income data for the 2013 tax year show the number of Hawaii personal income tax returns by filing status (single, joint, head of household) and by range of adjusted gross income (e.g., $10,000-$25,000). The Survey of Consumer Finances shows the percentage of households that own financial assets by household type (single with no children, married, single with children) and by income percentile. Using these figures, the aggregate AGI was estimated in ranges corresponding to Hawaii marginal income tax rate ranges and the average REIT dividend income per tax return in each cell. For example, the distributions of AGI and financial asset ownership suggested that single taxpayers with AGI between $9,600 and $10,000 received average REIT dividends of $11.19 per tax return, while married taxpayers with AGI between $500,000 and $1,000,000 received average REIT dividends of $1,997 per tax return. Thereafter, Hawaii's marginal personal income tax rates were applied to the estimated REIT dividends in each cell to estimate the incremental taxes paid on REIT dividends:

B. *REITs in Hawaii*

The scope of REITs' presence in Hawaii is indicated by some of the following indicators. Information from public REITs is more generally accessible than from those that are not listed with the SEC, so the data below are only a partial representation of REIT properties and developments in Hawaii. Nevertheless, some idea of their significance is suggested by the data.

- There are at least 84 REIT-owned properties in Hawaii.[39]
- The current fair market value of REIT-owned properties in Hawaii is approximately $11 billion.[40]
- The construction-related impacts of REITs in Hawaii in 2014 was an estimated 11,728 full-time equivalent (FTE) jobs and $482 million of labor earnings, as described in **Section III** of this study, but the total economic contribution of REITs and related companies in Hawaii has not been estimated directly.[41] Independent testimony submitted during the 2015 Hawaii Legislative Session contains elements of the latter calculation.[42]

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for example, it was estimated that the lower-income single taxpayer paid $0.72 in taxes on REIT dividends while the higher-income married taxpayer paid $220. Aggregating across all taxpayers resulted in an estimate of total Hawaii personal income taxes paid on REIT dividends of $8.8 million per year. It is important to keep in mind that this estimate includes taxes on only REIT dividend income, not capital gains realized from owning REIT stock. On a long-term basis, almost exactly half of total returns on REIT investments have been generated from income and half from capital appreciation.

[39] SNL Financial (based on SEC filings) (as of December 31, 2014).

[40] "REITs Across America" (http://www.reitsacrossamerica.com/#) (Property holdings reported as of December 31, 2014. Estimated property values based on the equity market capitalization of all equity REITs in the FTSE NAREIT All REITs Index as of December 31, 2014). (Source: NAREIT, SNL Financial and Company Financial Statements, available at www.sec.com).

[41] A national study prepared by EY for NAREIT, *Economic contribution of Real Estate Investment Trusts in the United States*, (forthcoming), using an input-output model to estimate the economic contributions of REITs in the United States in based on the 2013 *Impacts for Planning* (IMPLAN) input-output model of the United States, may shed more light on this question in terms of job associated with REIT properties, as opposed to construction impacts analyzed in **Section III** of this study.

[42] See "Statement of Chris B. Heaphy, Assistant Secretary, Taubman Centers, Inc. before the House Committee on Consumer Protection and Commerce and Committee on Judiciary in consideration of SB118, SD1 (March 18, 2015), available at http://www.capitol.hawaii.gov/Session2015/Testimony/SB118_SD1_TESTIMONY_CPC-JUD_03-18-15_.PDF (the Taubman Statement) regarding multi-year redevelopment of both International Market Place. See "Joint Statement of Francis Cofran, General Manager, Ala Moana Center, and Sandeep Mathrani, Chief Executive Officer, General Growth Properties (GGP) before the House Committee on Consumer Protection and Commerce and Committee on Judiciary in consideration of SB118, SD1 (March 18, 2015), available at http://www.capitol.hawaii.gov/Session2015/Testimony/SB118_SD1_TESTIMONY_CPC-JUD_03-18-15_.PDF (GGP's Statement). Specifically, Taubman's Statement noted that the redevelopment of International Market Place is projected to generate 1,000 jobs during construction and 2,500 future full time jobs, and GGP's Statement noted that redevelopment at Ala Moana Center is projected to generate over 11,000 jobs during construction and 3,000 jobs annually.

- In 2013, Hawaii residents are estimated to have paid state individual income taxes of $8.8 million on distributions from REITs.

- Hawaii REIT-owned properties range from health care facilities and hotels to industrial and self-storage properties, office buildings, multi-family structures and a variety of retail facilities ranging up to shopping centers and regional malls.

- REIT-owned properties include many prominent ones familiar to Hawaii residents, such as Wet'n'Wild Hawaii, Waikiki Beach Walk, Ala Moana Center, Pearlridge Center, and Waikele Premium Outlets.

- Hawaii REIT-owned property values total more than 15 percent of Hawaii GDP, ninth highest among the fifty states at current marks to market.

- Hawaii REIT investment amounts at historic cost were second highest among the states and the District of Columbia, which ranked first, in per capita terms and also when ranked by percentage of GDP, more than 9 percent for Hawaii (see **Figures 3** and **4**.)

This is not an exhaustive characterization of REIT-owned properties, but some context for these statistics is useful. Consider that: (a) Hawaii's population was 1.4 million residents in 2014[43]; (b) aggregate output or gross domestic product (GDP) in Hawaii was $77 billion in 2014[44]. Thus, in the real estate valuation context, $11 billion in Hawaii REIT-owned properties in Hawaii is not outsized but it is significant. During fiscal year 2014-2015, the four Hawaii counties' property tax bases collectively comprised $293.1 billion in real assets. This implies that publicly identifiable REIT-owned properties comprised about 4 percent of all taxable real property in Hawaii by this value measure.[45]

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[43] United States Census Bureau. See http://quickfacts.census.gov/qfd/states/15000.html.

[44] U.S. Bureau of Economic Analysis. See http://files.hawaii.gov/dbedt/economic/image_DB/gdp_1.png.

[45] See https://www.realpropertyhonolulu.com/content/rpadcms/documents/2014/14_state.pdf. Hawaii's capital/output ratio in terms of taxable real properties was 3.8 ($293.1 million divided by $77.4 billion in GDP). At a potential real GDP growth rate in a range of 2.0-2.5 percent, this capital/output ratio would be consistent with a private investment/GDP ratio of about 7.5-8.0 percent. While it is difficult to calibrate this theoretical concept, instructive upper and lower bounds are the $7.1 billion in average annual Hawaii contracting receipts, 2012-2014 (a gross receipts measure), and the average $4.1 billion Hawaii value-added in construction, 2012-2014 (a GDP measure). Against average Hawaii GDP of $75.1 billion, 2012-2014, these upper and lower bounds represent a range of 5.5-9.5 percent of GDP. Contracting receipts include some equipment investment (e.g. photovoltaic panels), while construction value-added typically is more strictly defined to include capital formation activity involving residential and nonresidential structures (the structures, not what sits on top them). Despite these measurement complexities, and recognizing that during the 2012-2014 interval Hawaii's recovery from the Great Depression of December 2007 through June 2009 was largely complete, it is arguable that investment activity recently has returned to a normal range in Hawaii relative to long-term economic growth parameterizations or, loosely-speaking, the mid-range of Hawaii's construction cycle. Identifiable REIT investments in Hawaii may comprise a somewhat more significant share of new capital formation in Hawaii, than their share of existing real assets.

Within the statewide total of the four county governments' property tax base, $213.3 million comprised residential property valuations, almost three-quarters of all taxable real property in the islands. Commercial property classifications comprise slightly less than one-quarter of the counties' property tax base total; agricultural and conservation lands made up most of the remaining assets.

In the commercial property asset classes in which REITs are invested in Hawaii, tax valuations total $66.5 billion. This would imply REIT ownership participation of around 17 percent *within those commercial asset classes*.[46] Again, these amounts only comprise 3.9 percent of all taxable real property in the islands. Note that these amounts reflect only REIT ownership for which public information is available. The fact that REITs hold about 17 percent of commercial real properties in Hawaii can be given some additional context by comparing tourism's value-added share of output in Hawaii, also around 17-18 percent,[47] and that of the federal government in Hawaii (including a larger than national average military share) around 13 percent of gross product (as of 2013).

This real estate value estimate is a market value for *physical* capital. There are other kinds of capital which, combined with labor and natural resource inputs, produce output. Human capital embodies investments in skill-formation through education and work experience. Knowledge capital or intellectual property and the body of methods and techniques comprising how things are produced are a kind of "software." Social capital can represent the value of networks across individuals in a community that add to its productive capacity, which across workers sometimes is taken into account by corporations as a measure of goodwill.

Physical capital represents produced means of production. In addition to equipment, commercial structures are long-lived assets that yield streams of productive services over time. In turn, these services generate streams of income over time which investors seek earn on their investments. In this way REIT shares in commercial real estate asset classes are like mutual fund shares in companies like banks or utilities or airlines: dividends enabled by these earnings flow through REITs and mutual funds to their ultimate shareholders. The key here is that physical capital enables other forms of capital—human, knowledge, social—to be agglomerated productively in ways in which, literally, the value of the whole exceeds the sum of its parts.

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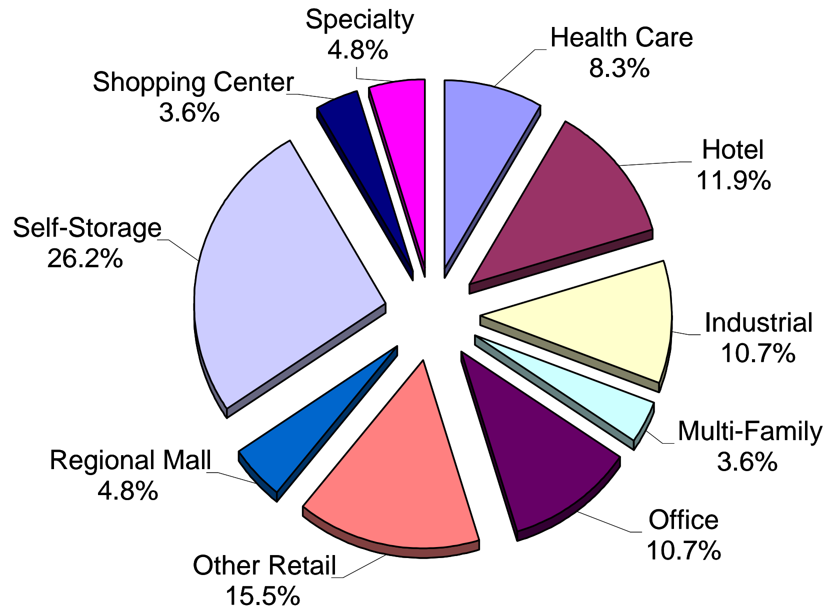
[46] This REIT-participating subset of commercial properties include those in county tax classifications Apartment, Commercial, Industrial, Hotel/Resort, Commercialized Residential, and Time Share. See City & County of Honolulu, Department of Budget and Fiscal Services, Real Property Assessment Division state reports (https://www.realpropertyhonolulu.com/content/rpadcms/documents/2015/15_state.pdf).

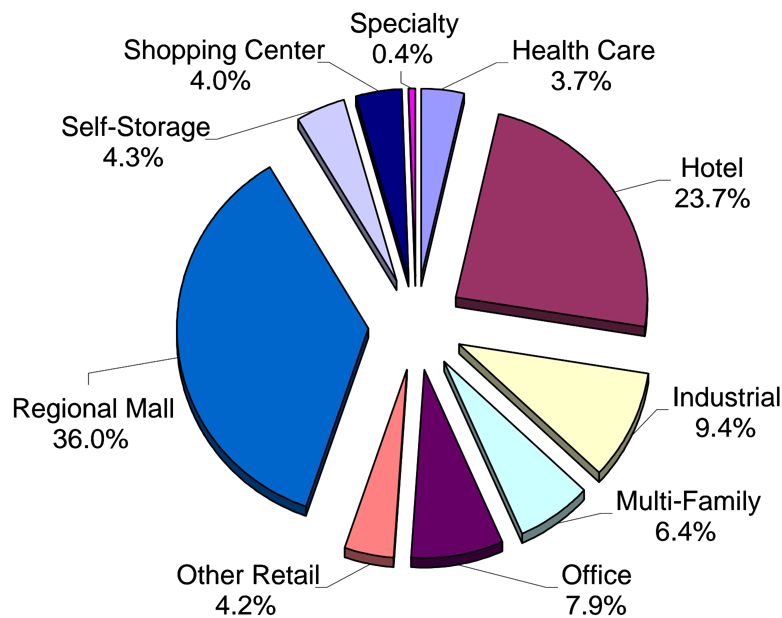
[47] See James Mak (2005), "Tourism demand and output in the U.S. Tourism Satellite Accounts: 1998-2003," *Journal of Travel Research*, **44** (1), pp. 4-5, and Eugene Tian, James Mak, and PingSun Leung, "The direct and indirect contributions of tourism to regional GDP: Hawaii," *UHERO Working Paper No. 2011-5* (July 28, 2011) (http://www.uhero.hawaii.edu/assets/WP_2011-5.pdf).

Figure 1. Public REIT-owned properties in Hawaii
by type and number of properties



Source: SNL Financial

Figure 2. Public REIT-owned properties in Hawaii
by type and initial cost



Source: SNL Financial

Figure 3. Per capita (resident) REIT investments by state, a partial ranking

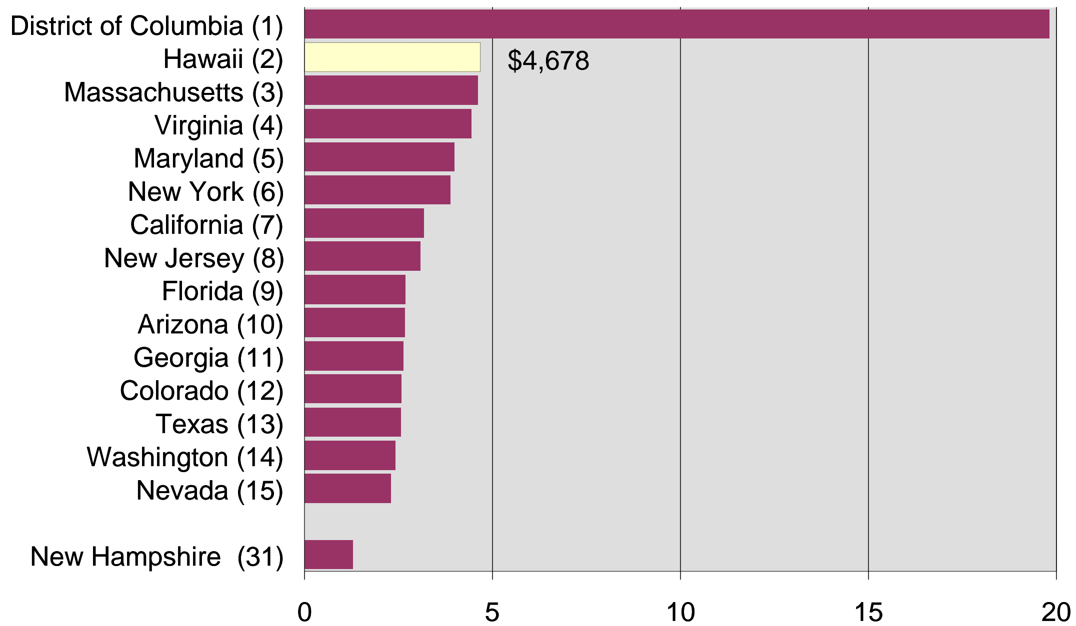
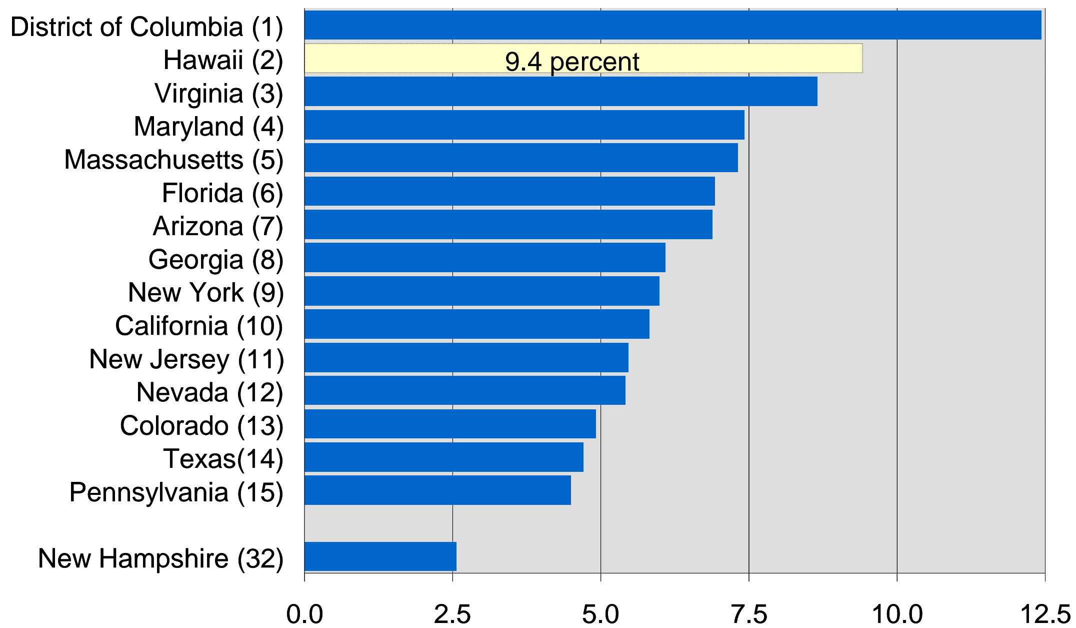


Figure 4. REIT investments as a percentage of state GDP, a partial ranking



Source: SNL Financial; U.S. Department of Commerce.

Table 1. Selected commercial properties owned by REITs in Hawaii

Office
Bishop Place
Bishop Square
Davies Pacific Center
Hale Pawa'a
Harbor Court
Honolulu Club
Kapiolani Medical Center for Women and Children
Kapiolani Medical Center Pali Momi
King Street/Fort Street Mall 1042
Pacific Business News
Pan Am Building
Waterfront Plaza
Hotel
Aston-Honolulu
Courtyard-Coconut Beach-Kauai
Courtyard-Waikiki Beach
Embassy Suites-Waikiki Beach Walk
Fairmont-Kea Lani Maui
Hyatt Ka’anapali Beach
Hyatt Place-Waikiki Beach
Hyatt Regency-Maui
Marriott-Lihue Kauai Resort
Marriott-Wailea Beach Resort & Spa
Retail
Ala Moana Center
International Marketplace
Pearlridge Center
Prince Kuhio Plaza
The Shops at Kalakaua
Waikele Premium Outlets
Waikiki Beach Walk Retail
Whaler's Village
Apartments
Moanalua Hillside Apartments
Villas at Royal Kunia
Waena Apartments
Kapolei Lofts

Sources: SNL Financial (based on publicly filed SEC data) (December 31, 2014), and Forest City Enterprise, Inc., (which will be a REIT effective January 1, 2016).

The $11 billion estimate of the value of REIT-owned properties in Hawaii can be compared to other forms of capital in Hawaii. For example, researchers at the University of Hawaii estimated in the early 2000s that the value of *natural capital* embodied by the upland forests of the Koolau watershed on Oahu, in nexus with instream flows, aquifer recharge capacity, nearshore reef and marine habitats and all of the associated environmental services, was about $10 billion.[48] We know what happens when the watershed is degraded, because Honolulu ran out of potable water at the turn of the 20th century following a prior century of upland deforestation. Similarly, we can imagine what would happen to the economy if REIT-owned commercial and residential properties like those enumerated in **Table 1** suddenly "ran dry," or evaporated. Much physical capital formation underway in Hawaii today would not occur in the future if REITs' investment playing field was tilted unfavorably.

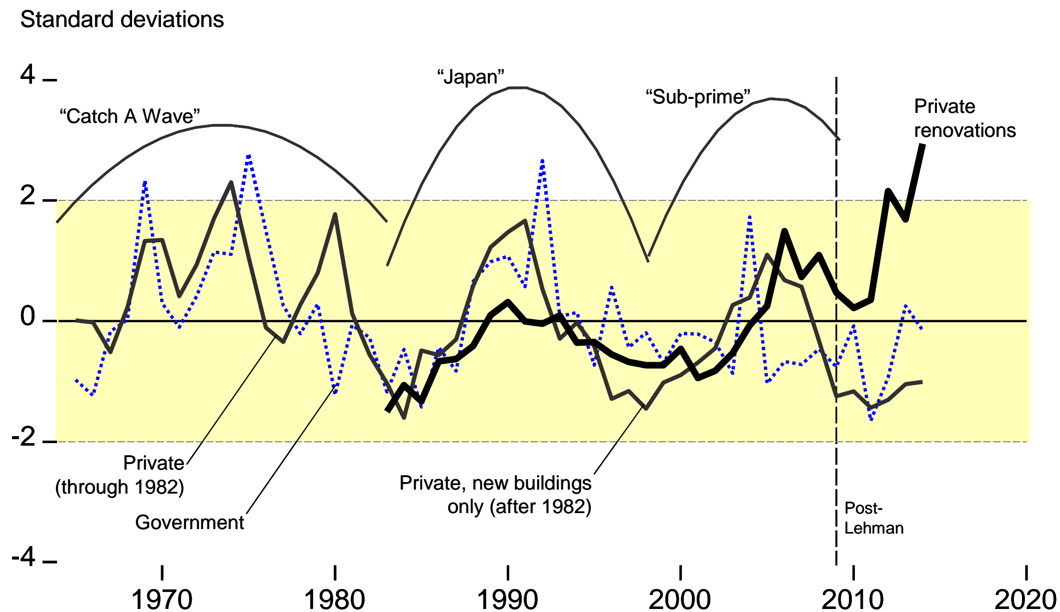
III. Economic impacts of REIT-related construction in Hawaii

A significant proportion of ongoing construction and investment activity in Hawaii is associated with REITs, perhaps more than at any time in the past. This section of the report provides estimates of economic impacts of this REIT-related activity. Even small numbers of selected, REIT-related projects illustrate their importance for overall Hawaii construction because of their large magnitudes and sheer scope. Hawaii physical capital formation through REITs provides access to deep pools of financial capital otherwise challenging to obtain in pursuit of large, transformative development and redevelopment undertakings.

A few REIT-related development projects in Hawaii illustrate what's at stake if Hawaii eliminates the dividends paid deduction for REITs, doubly-taxing investors' net incomes. For context, consider that in the half century since the early 1960, there have been three broad construction waves. The first wave, in the 1960s and 1970s with sub-cycles of its own, can be called the Catch A Wave cycle. The second wave in the 1980s and 1990s can be called the Japan Bubble. The third wave, in the early 2000s, aborted with the collapse of Lehman Brothers in 2008 and can be called the Sub-prime Bubble. The paths of private and public construction through these waves, as well as since 2009, are illustrated below in **Figure 5**.

[48] See Brooks Kaiser and James Roumasset (2002), "Valuing Indirect Ecosystem Services: the Case of Tropical Watersheds," *Environment and Development Economics* **7**:701-714, and extensions of this research program such as James Roumasset and Christopher Wada (July 30, 2010), "Optimal Provision and Finance of Ecosystem Services: the Case of Watershed Conservation and Groundwater Management," *UHERO Working Paper* No. 2010-12 (http://www.uhero.hawaii.edu/assets/WP_2010-12.pdf).

Figure 5. Private and public construction in Hawaii through three waves, 1964-2014 (depicted in standard deviations of inflation-adjusted values over fifty years)



Sources: County building departments, Hawaii DBEDT, Hawaii Department of Taxation, U.S. Bureau of the Census, based partly on historical compilations by Bank of Hawaii and First Hawaiian Bank.

In addition to the long-waves depicted in **Figure 5**, another notable trend is the growing dominance of renovations over new buildings in private construction commitments since the start of the 21st century.[49] Analogous to the role that foreign investors played during the Japan Bubble, and the role that mortgage lending and securitization played during the Sub-prime Bubble, REITs now are playing major role in Hawaii's 20-teens construction wave. Private renovations have become more and more important as an economic driver and some of the largest of these redevelopments involve REIT-owned commercial properties in Hawaii. REITs may be among the dominant investors in this renovation wave. Currently, renovations also appear to be more significant drivers than public construction in Hawaii at *all* levels of government (county, state, and federal combined), which only in the 20-teens has returned to its average of the previous half-century, in constant dollars, possibly because of public urban rail development. Private construction commitments in Hawaii for new structures in the years since

[49] Private renovations data here are the constant-dollar values of private building permits for additions and alterations, as opposed to permits for new buildings, subtracting the estimated value of construction commitments attributable to the State of Hawaii's renewable energy tax credits. The values of all construction commitments are deflated using the Census Bureau's implicit price deflator for construction which, unfortunately, is for residential construction only. (To the extent that this underestimates commercial construction inflation, cyclical upswings are overestimated.)

2008 are at an historic low ebb for investment cycles of the last half century.[50] Just how important a role REITs now play in private Hawaii construction activity, and what might be the consequences for construction in their absence, is considered in what follows.

To demonstrate the possibilities, a model of Hawaii construction activity was developed to estimate a counterfactual outcome in which several important REIT-related projects are removed from the data. Among the projects motivating this counterfactual calculation are the following:

- Waikiki Beach Walk, redeveloped from 2005-2009, initiated by Outrigger Enterprises and other investment participants (including California-based REIT American Assets Trust) on an "8 acre area, bordered by Kalakaua Avenue, Lewers Street, Kalia Road, Beach Walk and Saratoga Road, …completely rebuilt…[at] a total cost of $535 million."[51]

- Ala Moana Center redevelopment and refresh, from 2012-2015, a $573 million project initiated by General Growth Properties (with shares sold during redevelopment to AustralianSuper and TIAA-CREF). [52]

- International Market Place revitalization by development partners Taubman Centers, Inc. and CoastWood Capital Group, LLC, on 6 acres of Waikiki land owned by Queen Emma Land Company, from 2013-2016, at an estimated cost of $350 million.[53]

(In addition, for purposes of the counterfactual calculation, several hundred million dollars in other REIT-related construction, 2006-2014, are incorporated in the overall impact estimate.[54])

Actual Hawaii construction expenditure—constant-dollar contracting receipts on the State of Hawaii's General Excise and Use Tax Base—and counterfactual estimates with and without REIT-related construction are depicted below in **Figure 6**.

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[50] The numbers of new housing units authorized statewide for construction in Hawaii, 2009-2014 inclusive, is the lowest for *any* six-year period for which data are available since the 1950s. On Oahu, for which annual data are available back to 1928, new housing units authorized in the last six years are lower in absolute terms than at any time since World War II and, as a percent of the existing housing stock, are the lowest ever recorded except during world war. For Oahu new homebuilding, literally, "it's so good now, only world war was worse."

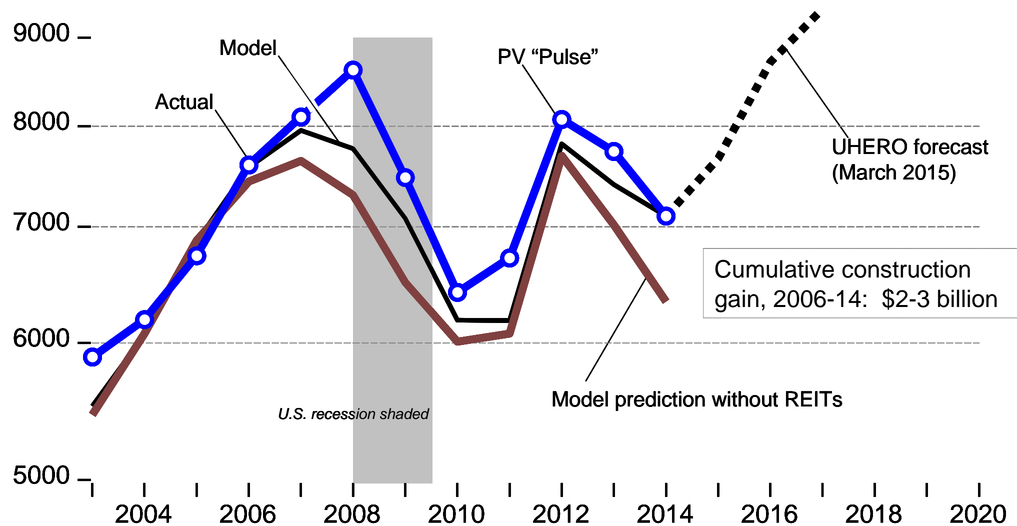
[51] Outrigger Enterprises Group (http://www.waikikibeachwalk.com/press_release_detail.aspx?prid=87).

[52] General Growth Properties (http://www.ggp.com/properties/development-projects/ala-moana-center) and Duane Shimogawa, *Pacific Business News* (http://www.bizjournals.com/pacific/news/2014/12/17/ala-moana-centers-573m-redevelopment-in-pictures.html and other articles by this reporter).

[53] International Market Place (http://shopinternationalmarketplace.com/media/).

[54] This estimate is very loosely motivated by knowledge of renovations at many of the properties identified in the descriptive section of this report in which identifiable REIT-owned properties in Hawaii are enumerated, as well as new projects by developers believed to have REIT relationships.

Figure 6. Actual, model estimates, and counterfactual estimates of annual Hawaii construction outlay in million 2014 dollars



Sources: County building departments, Hawaii DBEDT, Hawaii Department of Taxation, U.S. Bureau of the Census, University of Hawaii Economic Research Organization (http://uhero.hawaii.edu/assets/15Q1HawaiiConstructionForecast-Public.pdf).

The point of this exercise is not to build a construction forecast model *per se*, although the model employed here can be used to forecast construction. Rather, the point of this exercise is to estimate construction impacts with and without REIT-related construction. The impact of segregating approximately $1.5 billion in construction commitments represented by the three projects described above combined with other projects for a total just under $2 billion in REIT-related construction commitments is a counterfactual construction spending estimate $2-3 billion *less* than actually occurred cumulatively between 2006 and 2014 in constant-dollar Hawaii contracting receipts.

To be sure, $2-3 billion less construction over a nine-year interval (inclusive) against an annual average $7.5 billion in Hawaii contracting receipts may not be earth-shattering on its own. On the other hand, $2-3 billion is a lot of construction activity associated with a lot of construction jobs. Using State of Hawaii input-output multipliers, it is associated with roughly $4-6 billion in Hawaii gross product and *at least* an annual average 1,100 jobs over nine years would conservatively taking into account labor-saving productivity growth.

The economy-wide impact in Hawaii of REIT-related construction in the last five years, since the end of the Great Recession in 2009, using the State of Hawaii's input-output model, is presented below in **Table 2**.

Table 2. Economy-wide impacts of REIT-related investment, 2010-2014 using the State of Hawaii input-output model[55]

Million 2014$; jobs as noted	2010	2011	2012	2013	2014
GDP	417	250	279	849	1,624
Earnings	124	74	83	252	482
State tax	24	15	16	50	95
Jobs	3,172	1,877	2,064	6,208	11,728

Sources: This study and Research and Economic Analysis Division, Hawaii Department of Business, Economic Development, and Tourism (DBEDT) (Revised December 2013), The Hawaii State Input-Output Study: 2007 Benchmark Report (http://dbedt.hawaii.gov/economic/reports_studies/2007-io/); estimates exclude ongoing impacts of Ward Village in Kakaako, whose developer de-listed as a REIT in 2015, and adopts DBEDT's productivity growth assumptions (and consequent declining construction labor force requirements over the estimation interval). Additional assumptions regarding the amount of retail sales displacement associated with newly-developed retail square footage are taken from DBEDT's 2007 report. However, the estimates in **Table 2** de-emphasize outlays on architecture, engineering, and other development costs for which details are unknown and do not speak to certain longer-term effects associated with the creation of and reinvestment in productive capacity in retail distribution, food and beverage services, and in arts, entertainment, and recreation activities that may be associated with the transformed facilities.

These are relatively simple estimates based on the estimated differences between actual and counterfactual Hawaii construction illustrated in **Figure 6** for the most recent five years, 2010-2014 inclusive. The estimates include *all* economy-wide impacts—direct, indirect, and induced impacts—associated with REIT-related construction and investment activity and, through backward and forward linkages with construction, throughout the Hawaii economy.

Because the construction model from which these estimates is drawn involves a multi-year trajectory (a time series model), the cumulative impacts in constant (2014) dollars can be

[55] See **Table 2** source listings for details. Ongoing construction impacts prior to the completion dates of some of the projects are included but the impact estimates exclude other known REIT-related projects for which formal construction commitments have not been acquired (certain entitlements and building permits), even though planning, architecture, engineering and entitlement acquisition-oriented activities are underway. The economy-wide Hawaii impact estimates in **Table 2** can be broken down into those directly associated with construction and those indirect and induced impacts arising from inter-industry relationships with those projects. On average from 2010-2014 there were 2,063 construction jobs and 2,947 other jobs associated annually with these projects, yielding an annual average $135 million in construction earnings and $46 million in other earnings. Construction-related annual State tax revenue associated with these projects was $27 million on average; another $8 million arose annually from other associated impacts over the same five years. Annual average contributions to Hawaii GDP were $1 billion from construction activity and $429 million in other activity associated with these REIT-related investments. All breakdowns are expressed in constant, 2014 dollars, but not in present-value terms.

expressed equivalently in terms of present values in 2010, discounting subsequent years' outcomes. This answers the question, given what we now know about 2010-2014, evaluated at the start of the recovery in present-value terms and adjusted for construction cost inflation: "how much were REIT-related construction projects worth to Hawaii in total economy-wide impacts as they rippled through the economy via measured inter-industry effects?" The answer is a partial answer, as these projects will continue to have impacts in 2015, 2016, and possibly 2017. New projects will doubtless arise not included here, and even this partial answer ignores the *permanent* impacts of the new productive capacity created by these REIT-related developments. (For example, in its present form this study does not include estimates of the present values of future property tax revenues in real, inflation-adjusted terms.)

The summary impacts, 2010-2014, of REIT-related construction in Hawaii, in present-value terms from the standpoint of 2010 in inflation-adjusted, 2014 dollars are:

(*a*) $3.1 billion in additional Hawaii GDP over the five-year period, about half coming in 2014 as this construction activity and its multiplier impacts reached a crescendo.

(*b*) $934 million in workers' earnings during those five years, half coming in 2014.

(*c*) $184 million in State of Hawaii tax revenues (ignoring property taxes) over five years (the equivalent of 2-3 years' *total* Hawaii corporate income tax receipts).

(*d*) Approximately 5,000 jobs on average over five years, although more than twice that many as associated economic activity peaked in 2014.

Again, it should be expected that this REIT investment-originating impulse in real Hawaii economic activity would continue while tapering off in 2015 and 2016, and possibly 2017, not including any future, as yet unknown REIT-related activity.

Some of the dynamic impacts of REIT-related construction take the form of additional construction activities *induced* by the REIT-related projects themselves and implicitly picked up by the specification of the construction model.[56] For example, contractors employed in REIT-related developments may expand their warehouse, industrial, and job training facilities, or they may engage in their own private residential renovations as a consequence of the economic stimulus and wealth-enhancement attributable to REIT-related projects. The model is able to pick up an anomalous surge in photovoltaic panel installation driven by State renewable energy tax credits, peaking in 2012, and segregates it from the REIT effects, indicated by the label "PV pulse" in **Figure 6**. Also illustrated in **Figure 6** are published Hawaii construction forecasts by the University of Hawaii Economic Research Organization (UHERO). UHERO anticipates continued growth in real (inflation-adjusted) construction activity in Hawaii for the next several years. Doubtless some of this future construction activity also is associated with REITs.

[56] These indirect and induced effects are fleshed out in the input-output model, which relies on interindustry linkages to compare two static economic equilibria—with and without REIT-related construction—but does not compare alternative economic trajectories

Without getting too hung up on false precision, the point illustrated is straightforward. As with REIT property ownership in Hawaii, REIT-related construction in Hawaii is significant. Its presence has been material to recent Hawaii economic performance improvement more generally, and its contribution to Hawaii's ongoing construction upswing is especially notable.

As important as *magnitudes* of REIT-related construction activity are the *characteristics* of REIT-related construction. The three projects highlighted in the counterfactual estimation exercise are distinguished as major, transformative urban redevelopment initiatives in Honolulu. Redevelopment of Waikiki Beachwalk, Ala Moana Center, and International Market Place all involve *repositioning* of major, existing resort retail (and lodging) commercial real estate assets. In each instance the projects individually as well as collectively have been transformative investments for Waikiki and for Oahu, helping redefine the island as a tourism destination. The projects also adapt productive capacity to changing resident consumer preferences.

Very few individual investors—if any—and fairly small numbers of corporate players in Hawaii have capital markets access equivalent to what is enabled by REITs in these instances. Redevelopment may be even more important than suggested by the estimates reported here. The counterfactual analysis even some excluded REIT participation in Honolulu's urban core for technical reasons, so as not to appear to overestimate its impacts.[57]

Urban redevelopment as transformative repositioning of residential and commercial real estate assets in Hawaii is of growing significance in the early 21st century. During the mid-20th century, development was centered on building new productive capacity in Hawaii for emerging tourism exports and a burgeoning strategic role for Hawaii in Pacific geopolitics, as manufacturing and agricultural exports such as sugar and pineapple were eclipsed. Today, in the 21st century, development is centered on rebuilding existing productive capacity, enhancing it qualitatively while expanding it quantitatively. Especially on Oahu, urbanization is evolving away from greenfield development characterized by urban sprawl and outward spatial radiation of Honolulu's urban footprint, to redevelopment and more intensive use of existing urban spaces.

Oahu's "space-time continuum" increasingly is bogged down by negative congestion externalities. The value of open space and of agricultural and conservation lands as natural capital on Oahu—partly through inter-relationships with upland watersheds and nearshore environments—has become better appreciated. Just as renovation has grown relative to construction of new buildings in Hawaii, as illustrated in **Figure 5**, urban redevelopment is of growing relative importance in the formation of productive capacity in Hawaii compared to suburban and rural development. This refresh of Honolulu's urbanscape has been facilitated by REITs, which are folding large-scale development back into the urban core. REITs are an important financial vehicle for realizing more efficient use of existing Honolulu urban areas, and for reducing the need to pave over the islands' agricultural and conservation areas while expanding Hawaii's productive capacity.

[57] One Kakaako developer (Howard Hughes Corporation) revoked its subsidiary's status as a real estate investment trust in 2015. Another Hawaii developer, Forest City Enterprises, Inc. (parent of Forest City Hawaii, a major participant in U.S. Department of Defense privatization of military housing on Oahu since 2000), is electing REIT status effective January 1, 2016. Neither developers' activities are included in the counterfactual estimates.

IV. Hawaii tax policy and REITs

This section of the study informally considers three tax policy subjects from the perspective of public economics that are related to REITs in Hawaii. First, a review of simple tax economics is sketched, primarily because of Hawaii legislative consideration of removal of the dividends paid deduction (DPD) accorded to REITs, and because of the regulatory requirement and competitive practice assuring that virtually all REIT net income is paid to shareholders as dividends. Second, the particular and idiosyncratic nature of Hawaii corporate net income tax revenues is considered, partly for context. Third, some conjectures that might loosely be considered dynamic scoring hypotheses are suggested; true dynamic scoring quantifies revenue impacts of tax policy changes after *including* the behavioral changes *in response to* the policy change.

A. *Tax economics for undergraduates*

Revenue adequacy, economic efficiency, and fairness or equity are three pillars of a sound tax system, according to what is commonly taught to undergraduate economic students.[58] Tax revenue is adequate only in the context of government expenditures which, typically in democratic process, rely on mechanisms for revelation of public preferences to be set "just right."[59] Social democracies that embrace public mass transit and universal health care coverage, for example, tend to have tax levels higher than polities that eschew public mass transit and incompletely provide citizens access to health care.[60] An efficient tax system is one in which economic outcomes are least likely to diverge from those in a setting without taxes, if it were possible for the modern economy to function without a public sector. For example, the prevailing view among economists is that double taxation of corporate income causes economic distortions and market inefficiencies resulting in the *mis*allocation of capital.[61] Because the evaluation of fairness or equity involves interpersonal comparisons of welfare, economics tends to offer limited if often quantitatively rigorous guidance with regard to what is fair and what isn't in taxation. Economic is not as well-suited to questions of equity as it is questions of efficiency.

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[58] See, for example, a more expansive variation on these themes emphasizing equity (fairness) on pages 9-10 of *the Final Report of the Real Property Tax Advisory Commission* (January 2012) of the City & County of Honolulu (http://www4.honolulu.gov/docushare/dsweb/Get/Document-120786/cc15.pdf). This section also draws partly on the author's lecture notes for Economics 311, *Hawaii's Economy*, at the University of Hawaii, following a tradition established by the course's originator, Professor James Mak of the Department of Economics at the University of Hawaii at Manoa.

[59] Paul H. Brewbaker, "Are taxes in Hawaii too high?" chapter 13 in Randall W. Roth (ed.), James Mak and Jack P. Suyderhoud (technical editors) (1992), *The Price of Paradise*, Mutual Publishing, Honolulu.

[60] See, for example, comparable data on central government tax revenues as a percent of GDP for such countries as Austria (18.3 percent, 2006-2010) and the United States (10.2 percent, 2006-2010) published by the World Bank (http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS).

[61] *See, e.g.*, http://taxfoundation.org/article/eliminating-double-taxation-through-corporate-integration or http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_15_en.pdf.

A recent Hawaii legislative proposal to eliminate the DPD for REITs directly raises such issues as revenue adequacy, economic efficiency, and fairness or equity. Perennial issues of revenue adequacy are one context for consideration of REIT DPD removal.[62] REITs pay out virtually their entire net income to shareholders through dividends, where it is taxable as dividend income. This was intended by the U.S. Congress in establishing REITs as an investment vehicle. Absent a dividends paid deduction, a REIT paying Hawaii State corporate net income taxes first, and then distributing its after-tax income as dividends, would subject its shareholders to double taxation. Double taxation of capital income is a notorious distortion in the economic theory of taxation, one that reduces society's welfare. It reduces investment, other things equal, which is the formation of new capital, the economy's productive capacity. So, eliminating the DPD for REITs is a mechanism through which Hawaii, over time, would form less productive capacity—less investment in new productive capacity—risking lower productivity and lower aggregate income in the future.

Double-taxing capital income reduces optimal productive capacity in a couple ways. It increases the cost of the capital itself. A given amount of investment funding cannot finance as much actual development if returns on those investments are reduced by increasing taxes on their investment income. That is, double taxation of capital income reduces the optimal *stock* of productive capacity. Given today's capital stock, a lower optimal stock of capital tomorrow implies a smaller *flow* of investment transforming today's existing productive capacity into tomorrow's new productive capacity. That is, double taxation of capital income reduces construction, the flow of new capital formation. Double taxation of capital income could induce *dis*investment, not just relatively less construction of new productive capacity, but actual deconstruction of productive capacity to achieve a lower capital stock.

By reducing competition or contestability in Hawaii commercial real estate markets, the introduction of double taxation of capital income arising from a *particular* form of investment, such as REITs, might enhance the dynamic gaming strategies of wealthy individual investors. Historically, this is a classic example of protectionism or special interest politics and a more prominent feature of the ruling oligarchy during Hawaii's Territorial Era before statehood. The Congress specifically sought to counter such concentrations of wealth and political power when it enabled REITs in 1960. Limiting competition or inhibiting contestability in markets for commercial real estate reduces the probability that properties will be operated in the most efficient way possible, to generate the greatest rents, and to maximize community benefits.[63]

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[62] Revenue adequacy will confront the new City & County of Honolulu Real Property Tax Advisory Commission (http://erniemartinatcitycouncil.com/tag/oahu-real-property-tax-advisory-commission/) and were important to the State of Hawaii Tax Review Commission 2010-2012 (http://tax.hawaii.gov/stats/a9_2trc/).

[63] *See* William Hardin III, Matthew Hill, and James Hopper (2009) Ownership Structure, Property Performance, Multifamily Properties, and REITs. *Journal of Real Estate Research*: 2009, Vol. 31, No. 3, pp. 285-306. "[I]ncreased operating performance (due to higher rents when REIT owns and operates properties) provides another reason REITs are willing to acquire properties at slight premiums to the prices paid by other investor groups. As an investment vehicle, REITs can benefit from increases in effective rent at the property level as well as previously documented cost or scale efficiencies. In a general sense, the REIT ownership structure represents diversified scale operators with property management skills. The benefits are not only cost related scale economies, but also include

Financial innovation in Hawaii since REITs were enabled in 1960 relies on an important principle customarily embraced by Hawaii tax law. This is the principle that a financial conduit which simply pools investor resources, distributing net incomes from collective investments back to those same investors, should *not* itself be taxed on those flows. The *individuals* should be taxed, not the conduit.

In Hawaii, this is related to the principle that exempts commercial banks, savings and loans, and credit unions from paying the Hawaii general excise tax, a gross receipts tax, on deposits received from or interest paid to their banking customers.[64] After all, these financial institutions are receiving funds from their depositors (and shareholders, in the case of credit unions), who then receive interest. These depository institutions *intermediate* between creditors (depositors) and debtors (borrowers), but the act of receiving a deposit does not create a taxable gross receipt, nor is the income earned from borrowers who pay interest on their loans a taxable gross receipt. It's true that commercial banks and savings banks—but not credit unions—pay a corporate net income tax, but that's because, unlike REITs which are single-purpose vehicles, most depository institutions have multiple lines of business across the spectrum of financial services, and because, unlike REITs, financial institutions have no distribution requirements.[65] Commercial banks and savings banks also can retain corporate earnings or deploy them through share buybacks to enhance shareholder value quite apart from operating more efficiently as lending institutions. Nevertheless, the principle that intermediaries to the extent possible should not be taxed on intermediation *per se* is a common thread in financial regulation.

Interest income earned by the commercial bank, savings bank, or credit union depositor—the individual's income—*is* subject to individual income taxation, just as is an individual's dividend income. Interest and other financial services income at a bank is not income of its corporate shareholders *until* costs of funding bank loans and other costs of financial services operations are netted out. Only then, and only because it then becomes an individual shareholders' income tax liability, is such dividend income subject to Hawaii income tax. The same is true of dividends paid to individuals who are REIT investors in Hawaii: they pay income tax on their dividend income, as they do on other income such as wages and salaries.

A wealthy individual who incorporates ownership of an apartment building, for example, must pay Hawaii's corporate net income tax because the corporation owns the apartment building. She also has to pay the individual income tax on the dividend income she earns from

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revenue enhancements due to the ability to better assess market and sub- market supply and demand and make adjustments in rent. The results imply that the structure of property ownership impacts property performance."

[64] Strictly speaking, financial institutions in Hawaii pay a franchise tax in lieu of the general excise tax which, in principle, still should apply to *non*financial intermediation-related income. In the language of the *Report of the Tax Review Commission* (December 1, 1989) (page 41): "Consistent with the concept of a consumption based tax, the GET should not be levied on the entire amount of insurance premiums since much of it is a form of savings rather than consumption. Similarly, dividend and interest income earned from investment portfolios are not consumption and should be [GET] exempt." See http://files.hawaii.gov/tax/stats/trc/docs1989/1989_TRC_Report.pdf.

[65] At any rate Hawaii corporate net income taxes apply only at the holding company level for deposit-taking financial institutions because of the broad array of assets, typically across the full spectrum of asset classes including real estate, from which financial subsidiary net incomes are upstreamed to the holding company level.

any dividends that are distributed by her corporation, the one that owns the apartment building. For that matter, she would pay individual income tax if she owned a lunch wagon, or a nail salon, or an industrial equipment leasing company, as long as they generate income for her. The choice whether to structure holdings as personal assets, in partnerships or corporations, or in more financially innovative vehicles, however, is a personal financial decision. If double-taxation *is* a problem arising from such decisions for *some* investors in Hawaii, the better remedy for those investors is to solve their problem directly, not to make a problem for other investors.

Financial innovation generally, and the enabling federal legislation that made REITs an investment vehicle in 1960, in particular, both are a part of a process of *democratization* of financial markets and institutions in their evolution during the late-20th century.[66] This process of financial innovation improved society's welfare. In addition to increasing individual investor access to financial asset ownership, financial innovation increased access to credit because obtaining credit requires being able to pledge collateral—some portion of personal wealth. One hundred years ago in Hawaii, when assets (and especially real estate assets) were held by small numbers of wealthy individuals and families, access to ownership *and* to credit was limited for the rest of the population, excluded from real estate ownership in the absence of REITs.

Modern-day securitization provides a channel for greater inclusivity. Rather than owning real estate outright, or instead of forming a family *hui* or a partnership or corporation, real estate investment trusts are able to provide access to ownership of many different kinds of real estate assets for millions of individual investors, for small investors. People participate in REIT ownership either through their personal investing or through their pension funds, insurance companies, and other investment services providers. This enables less wealthy individuals and households to build wealth portfolios combining smaller, diverse investment holdings. It provides them with the collateral and access to credit that previously they would not have had. The democratization of the U.S. financial system through financial innovation and securitization in large part is the reason why the U.S. ranks so highly, worldwide, in financial sophistication and accessibility. REITs are part of the process by which the U.S. financial system has become more efficient and its benefits more fairly distributed.

B. *Hawaii corporate net income taxes*

Hawaii collects a statistically insignificant amount of its total State budget from corporate income tax revenues. Hawaii corporate net income tax revenues were constant-dollar annual average of $95 million in 2014 dollars for the last forty-five years, out of total state revenues exceeding $14 billion in the current fiscal year (14.0 versus 0.1).[67] On trend, Hawaii real

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[66] *See*, e.g., F. Packer, T. Riddiough & J. Shek, *Securitization and the Supply Cycle: Evidence from the REIT Market*, J. Portfolio Management, Vol. 39 pp. 134-143.

[67] Hawaii Council on Revenues. See the September 2015 General Fund tax revenue forecast http://files.hawaii.gov/tax/useful/cor/2015gf09-03_with0910_Rpt2Gov.pdf, and projected revenue from sources other than General Fund tax revenues http://files.hawaii.gov/tax/useful/cor/2015gf09-03_attach_3.pdf.

corporate net income tax revenues were about $66 million in 2014,[68] and fiscal year 2015 corporate tax revenues were $52 million.[69] By contrast, the largest State of Hawaii revenue components are the General Excise Tax (GET) ($2.97 billion in 2014, $3.05 billion in fiscal 2015), federal revenue sharing (a projected $2.86 billion in fiscal 2015), charges for current services (projected $2.20 billion in fiscal 2015), and the individual income tax ($1.82 billion in 2014, $1.99 billion in fiscal 2015), which includes taxes on REIT dividend income.[70]

The idea that doubly-taxing REIT net incomes would have a material impact on Hawaii corporate net income tax revenues is implausible. Doubly-taxing REIT net income may make it untenable for REITs to fulfill their shareholder obligations by owning real estate assets in Hawaii. When combined with the direct reduction in GET and income taxes from diminished REIT-related construction, fewer jobs, and lower earnings, and from the reduction in business and individual incomes because of indirect and induced impacts of lower REIT-related construction, the State of Hawaii is likely to incur a net revenue loss if it removes the DPD for REITs.[71]

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[68] Calculated by regressing the natural logarithm of the annual constant-dollar value of Hawaii corporate net income tax revenues on a time trend, and projecting log-linearly the regression model's estimate.

[69] Department of Taxation (http://files.hawaii.gov/tax/stats/monthly/2015-07.zip). FY 2015 corporate income tax revenues were less than 0.8 percent of Hawaii General Fund Revenue, and less than 0.4 percent of total revenue.

[70] State of Hawaii non-revenue receipts are projected at $2.04 billion in fiscal 2015 (see footnote 67).

[71] Hawaii's "foregone" corporate income tax revenue from REITs is *not* equal to the product of Hawaii-sourced rental income times the Hawaii corporate net income tax rate, arithmetic that reflects several invalid assumptions regarding taxation of multistate business entities. The bad math considerably exaggerates any potential corporate tax revenue from REITs. First, the math fails to recognize that most multistate corporations engaged in the rental property business file what is known as a combined tax return in Hawaii. Essentially, such corporations must calculate combined taxable income of all of the various business entities in the rental property business at the federal level and then apportion this taxable income among the various states in which they do business based on a combination of factors. Not all rental income earned in Hawaii would be apportioned back to Hawaii (*see* http://www.cost.org/workarea/downloadasset.aspx?id=70000.) Second, if Hawaii increased the tax rate on income apportioned to Hawaii, affected REITs would re-allocate capital, payroll, and property to other states (or countries) where greater returns on investment would be available. This redeployment would reduce further the taxable income apportioned to Hawaii. Third, public REITs operating in Hawaii need to revisit capital markets regularly to raise additional capital. Non-REIT entities, in contrast, employ significantly higher levels of debt and utilize the corresponding interest deductions (along with other tax minimization techniques) to reduce their taxable income. Public REITs incur only modest amounts of debt. Eliminating the DPD would encourage investors in Hawaii to incur more debt and to increase their interest deductions in order to reduce any potentially taxable income. Fourth, while Hawaii might be able to collect some increased corporate income tax from double taxing REITs in the very short term, capital is highly mobile and REITs can allocate their resources elsewhere where returns on investment would be higher. This would shift Hawaii property ownership towards tax-*exempt* investors which are not subject to tax on rental income in Hawaii. (See http://nreionline.com/institutional-investors/pension-funds-endowments-hunger-real-estate-assets and https://www.preqin.com/docs/reports/Preqin-Investor-Outlook-Alternative-Assets-H1-2015.pdf). They also tend not to have the extensive management experience of public REITs, and are less likely to make the extensive investments necessary to generate the increased economic activity and jobs from which additional net income and tax revenue arise. Thus, while there might be a short-term blip of increased corporate income tax revenues initially, if Hawaii doubly-taxed REITs, it could mean a net reduction in overall tax revenues as a result of dynamic impacts, through disinvestment and capital flight.

Hawaii's corporate net income tax revenue from *all* Hawaii corporations with a tax liability hasn't been material to overall State of Hawaii revenues or even to General Fund revenues in Hawaii for several decades. As recently as this January, 2015, the author's testimony to a joint informational briefing of Hawaii legislative money committees underscored this point.[72] On that occasion it was observed, but only upon being asked by a committee member, that corporate net income tax receipts not only were immaterial to State revenues and spending, they frequently were smaller than the tolerance interval (plus or minus one or two percentage points) that Hawaii Council on Revenues members informally assigned to their State General Fund revenue growth forecasts as an acceptable margin of error.

In 1997, when discussions involving Governor Cayetano's Economic Revitalization Task Force (ERTF) recommendations were underway, it was observed that eliminating Hawaii's corporate net income tax altogether might have a signaling benefit to Hawaii greater than the revenue the State receives by taxing corporations. The ERTF recommended reducing corporate tax rates by half. Among the reasons cited by Chris Grandy in his review of ERTF proposals:

> *Economists concerned with economic efficiency focus on* rates *of taxation rather than the total or average amounts collected. They believe that people respond to the world incrementally, that the decision to take a second job or to expand into a new line of business depends on the expected* additional *costs and* additional *benefits* [emphasis in the original text].[73]

During the economic recovery since the Great Recession of 2008-2009, calendar year Hawaii corporate net income tax receipts have followed the business cycle from a recession low of $41.1 million (in 2014 dollars) during 2009, the last year of recession. An abortive corporate income tax rebound in 2010 unraveled in 2011, when the annual total was $20.7 million (in 2014 dollars). Economic recovery thereafter increasingly took hold, buoyed by a sharp rise in commodity prices (like sugar), and corporate tax revenues rose to $137.3 million during 2013 (in 2014 dollars). An economic Soft Patch in Hawaii and an unwinding of the global commodity price bubble led Hawaii corporate tax revenues to drop to $65.7 million in 2014, as alluded to earlier, and to $52.3 million in the fiscal year ending June 30, 2015, not adjusted for inflation.

In constant, 2014 dollars, Hawaii corporate net income tax receipts have been trending downward for nearly a half century, from around $110 million in 1969 to around $66 million in 2014 (calendar years). This represents annualized erosion in real terms of about 0.45 percent each year over the last 45 years.[74] The reasons for this erosion may have to do with more

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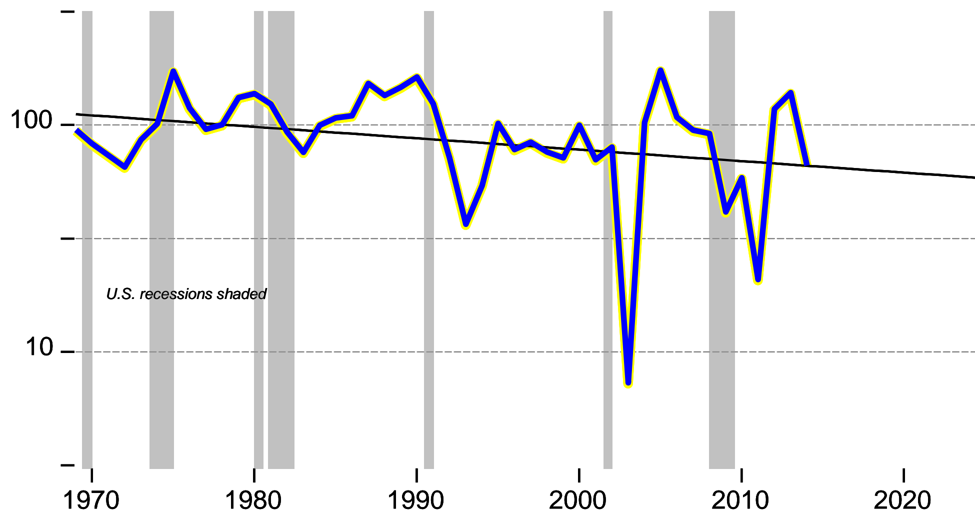
[72] The author's testimony posted on the Hawaii Senate Ways and Means Committee web site includes only his PowerPoint slides, not reference to the commentary following in the Q&A. See: http://www.capitol.hawaii.gov/session2015/testimony/Info_Testimony_WAM-FIN_01-21-15_Brewbaker.pdf.

[73] Christopher Grandy (2002), *Hawaii Becalmed: Economic Lessons of the 1990s*, University of Hawaii Press, Honolulu, page 67, and its Appendix 1, pp. 115-117, for itemization of the ERTF policy proposals.

[74] In 1969, when the Hawaii Department of Planning and Economic Development's estimate of Hawaii GDP was $10.6 billion in current dollars, corporate income taxes in Hawaii were $14.4 million, about 0.135 percent of GDP.

aggressive corporate tax planning, among other things, but it is clearly a phenomenon that is not unique to Hawaii, and precedes the introduction of the Internet in the mid-1990s.[75]

Figure 4. Hawaii annual corporate net income tax receipts, 1969-2014, calendar years, in millions of constant, 2014 dollars (log scale)



Source: Hawaii Department of Taxation, Bureau of Labor Statistics (author's calculations).

Even if Hawaii corporate net income tax revenue had not declined steadily for the last 45 years, the political reality is that the corporate income tax is retained mostly because of populist considerations, not because of economic considerations. If Hawaii legislatures were seriously concerned about the potential amounts of foregone State revenue upon repeal of the corporate income tax, they could eliminate or claw back state tax credits that result in an even greater annual revenue loss to the State. For example, the Hawaii State Auditor estimates that high technology business investment tax credit claims have cost the state an average of $70.4 million annually, fiscal years 1999-2012, annual amounts larger than corporate net income tax receipts in calendar 2014, annual amounts approaching average constant-dollar corporate tax receipts 2000-

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In 2014, the U.S. Bureau of Economic Analysis estimate for Hawaii GDP was $77.4 million, and corporate income taxes in Hawaii were $65.7 million, about 0.085 percent of GDP.

[75] See Appendix D to the 2001-2003 Hawaii Tax Review Commission Report, by William F. Fox and LeAnn Luna (June 5, 2002), *State Corporate Tax Revenue Trends: Causes and Possible Solutions* (http://files.hawaii.gov/tax/stats/trc/docs2003/trc_app_d2003.pdf).

2014 ($83 million), and more annually than the corporate income tax trend projection in **Figure 4** for the years 2015-2025.[76]

The 2005-2007 Hawaii Tax Review Commission proposed eliminating the Hawaii corporate net income tax altogether. In its final report, this commission argued:

> *The academic literature on the topic* [of corporate net income taxation] *indicates that small open economies, such as individual states, shoot themselves in the foot when they tax corporate income, because in the long run the burden of the tax is borne by local landowners and workers, not, as popularly believed, by the corporate shareholders.*[77] *Such jurisdictions can improve the competitiveness of their economies and the welfare of their residents by exchanging corporate income taxes for taxes on wages and land.*[78] *Popular notions of equity may explain why many small jurisdictions continue to apply corporate income taxes.*

The answer to the question, "why are REITs not subject to corporate income taxation?" is simple: REITs distribute most net income which is taxable as dividends to shareholders, in keeping with the principle that intermediation should not be taxed, only final income. A more interesting question is why, when yielding so little revenue, does Hawaii still have a corporate net income tax? Its elimination or diminution repeatedly has been proposed, and the State gives away much more in tax credits of dubious efficacy than it receives in corporate tax revenue.

C. *Barriers to capital mobility*

This study has highlighted the idea that eliminating the dividends paid deduction for REITs in Hawaii would reduce investment in Hawaii, or induce disinvestment in Hawaii, and as a consequence would be unlikely to generate significant corporate net income tax revenue. It

[76] The Hawaii State Auditor estimates that $1.7 billion in technology tax credits have been distributed as tax expenditures and that an estimate of $2 billion is not unreasonable, given that the credits have no sunset date and no cap, and no mechanism for evaluating their efficacy. See, "Credits Continue to Tax the State: Follow-Up on Recommendations Made in Report No. 12-05, Audit of the Department of Taxation's Administrative Oversight of High-Technology Business Investment and Research Activities Tax Credits *Report No. 15-11* (September 2015) (http://files.hawaii.gov/auditor/Reports/2015/15-11.pdf).

[77] [Footnote in original text] "These arguments are presented in greater detail in Tax Research and Planning Office, Hawaii State Department of Taxation, *Study on the Progressive or Regressive Nature of Hawaii's Taxes*, and Tax Research and Planning Office, *Study on the Question 'Is Hawaii's Tax Structure Adequate?'* report prepared for the 2005-2007 Tax Review Commission, November 2006."

[78] [Footnote in original text] "In a letter to the 2001-2003 Tax Review Commission (included in the last two pages of the [Commission's] report), Lowell Kalapa, President of the Tax Foundation of Hawaii, argued that the Commission should consider reducing or eliminating the Corporation Income Tax, on grounds that it contributed little to the State's revenue, but that reducing the rate would 'go a long way toward improving the attractiveness of Hawaii as a place to invest and do business.'"

conjectures that elimination of the DPD risks a net revenue loss to the state and negative consequences for the state economy.[79]

The dividends paid deduction, together with the requirement to distribute nearly all taxable income to shareholders, are the foundation of the REIT concept. The requirement to distribute at least 90 percent of taxable income to shareholders is not economically feasible without the complementary dividends paid deduction to offset the nearly total payout of the REIT's income.

If the dividends paid deduction were removed on a national basis, REITs would stop operating as REITs to eliminate the income distribution requirement. However, if eliminating the dividends paid deduction *only* in Hawaii, REITs would not choose to change their form of organization and lose their investors by shedding their REIT status; they would simply stop doing business in Hawaii, where REIT investments are second highest nationwide on a per resident and per GDP basis (see **Figure 3** and **4**). Creating an economic barrier to capital mobility that induces REITs to leave Hawaii, by disinvesting, would shrink the state economy. Construction impacts associated with REITs similar to those analyzed earlier in this study, illustrated in **Figure 6**, and enumerated in **Table 2**, would be foregone.

It is highly unlikely that capital from local investors would be sufficient to make up for the loss of REIT-supplied capital associated with these jobs and incomes, because REITs are not limited to raising capital from one geographical area or from one type of investor. REITs are aggregators of capital, not just from one state or even one country, but from around the world. Their investors are as diverse as the individual investors who own mutual funds and individual stocks, the mutual funds that make up our nation's 401(k) retirement plan system, the large pension funds that invest to provide retirement security for public employees throughout the country, and the sovereign wealth funds that invest in national assets. REITs bring all of these diverse sources of capital to bear on projects that offer the promise of higher returns and divert capital from areas with lower returns. They have the ability to put capital to work to support jobs and income in Hawaii or to take capital elsewhere, which would put more than 10,000 Hawaii jobs and more than $600 million in labor income at risk.

Eliminating the REIT dividends paid deduction in Hawaii may benefit only a small class of potential investors, especially when policy-makers simply could lower or eliminate corporate income taxes to the benefit of not only this class but of all corporations in Hawaii, potentially raising investment. Hawaii could even reduce corporate taxation in a revenue-neutral fashion, *and* in a manner that improves economic efficiency, through compensatory elimination of poorly-regarded tax credits. The point is that better alternatives exist to making bad tax policy (eliminating the REIT dividends paid deduction) on top of already bad tax policy (increasingly fruitless taxation of corporate net incomes).

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[79] The hypothesis of adverse State revenue and state economic impacts arising from elimination of the DPD for REITs in Hawaii might best be tested using a class of models known as computable general equilibrium models parameterized to Hawaii economic conditions, but this exercise goes beyond the current scope of this study.

There are two ways that additional taxation as a barrier to capital mobility might reduce REIT investments in Hawaii. First, an increase in taxes—beyond *existing* taxes on REIT investors' dividend incomes—would raise what is called the user cost of capital. Intuitively, this is the economic cost of using capital for an additional period. Even if you are "renting" your own capital from yourself there is an opportunity cost from tying up its use. Construction is physical capital formation, an adjustment from a lower current to a higher future capital stock. A higher user cost of capital is associated with a lower future capital stock. If you're planning to expand a shopping mall, a higher capital cost decreases its target size. Less investment ensues.

Adding a tax or withdrawing an exemption raises the cost of capital, making it more expensive to build new productive capacity. It's not that a hypothetical tax increase is *the* only thing that could to undermine a construction project's viability: higher interest rates do the same thing. However, in an economic union like the United States with highly mobile capital, a union in which *every* other state except one does not impose an additional tax on REITs, competition may lead capital to flow to one of the 48 states without the tax distortion, away from Hawaii. Unlike rising interest rates that affect all states equally through higher user cost, a higher tax in Hawaii benefits all *other* states by only raising the user cost of capital in Hawaii.

The second way adverse consequences may arise from elimination of the dividends paid deduction for REITs is a phenomenon known as signaling. Although capital is highly mobile—giving every state competitive access to global capital markets—information available to investors is asymmetric. People in Hawaii know more about how things work in Hawaii than people outside Hawaii. Not every Wall Street investor, pension fund, or insurance company investment committee is as familiar as are people in Hawaii about political and economic conditions in the islands. Local knowledge is costly for outsiders to obtain, presenting a challenge for Hawaii in attracting capital. Information technology has diminished information asymmetry. Still, a good reputation as an investment host is valuable because it reduces investors' costs of verification. Conversely, a reputation for changing rules in the middle of the game can signal adversely the credibility of a host jurisdiction's commitments to investors.

If for fifty years a state has taxed REIT dividends only once, an investor may take that as a signal that the state's investment climate is stable and predictable. Tax environments vary from state to state. Legislatures try *not* to misalign their tax systems too extremely from others' systems to avoid deterring investment by sending the wrong signal to investors. While tax systems can vary so far as either not having an individual income tax (like Texas) or having the lowest major city residential property tax rate in the country (like Honolulu),[80] when evaluated as a whole Hawaii frequently ranks among the higher-taxed states overall.[81] There's more at

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[80] U.S. Bureau of the Census, *Statistical Abstract of the United States 2012*, Table 448. Residential Property Tax Rates for Largest City in Each State: 2009 (https://www.census.gov/compendia/statab/2012/tables/12s0448.pdf).

[81] Or, Hawaii is more regressive: *op cit*. footnote 78, Table 447. Estimated State and Local Taxes Paid by a Family of Three for Largest City in Selected States: 2009 (https://www.census.gov/compendia/statab/2012/tables/12s0447.pdf). The 2010-2012 Hawaii Tax Review Commission compiled findings of prior commissions, three of which (1988-90, 1995-97, and 2005-07) recommended "Lower[ing] the overall level of [Hawaii] state taxes" (http://files.hawaii.gov/tax/stats/trc/docs2012/trc_rpt_2012_appendices_A-H.pdf).

stake for Hawaii, perceived as a higher-taxed state, in signaling accurately what investors will face.

Investment can be undermined by higher uncertainty, which reduces risk-adjusted investment returns just as do higher interest rates or higher taxes. Predictability of the investment environment reduces the inherent uncertainty facing large or irreversible construction and investment decisions. Signaling that Hawaii supports investment, based on consistent tax rules, helps build a reputation that helps to overcome uncertainty. In recent years, Hawaii's reputation as an investment host suffered after its Supreme Court in 2009 excluded an interisland passenger ferry already in commercial operation, bankrupting it. More recently, construction of high-elevation astronomical facilities, following nearly fifty years of space research on the same mountaintops, has been clouded by the lack of clarity regarding new facilities' prior regulatory approvals. The signal being sent to investors in these instances is more mixed and less predictable. The resulting increase in uncertainty tends to reduce investment.

Repeal of the DPD for REITs in Hawaii probably would result in a net revenue loss to the State from a combination of bad consequences for the Hawaii economy. By raising the user cost of capital, double-taxation of REIT income would reduce investment returns directly. By reducing the future optimal stock of productive capital, double-taxation of REIT income would reduce the flow of construction and investment. Doubly taxing REITs in Hawaii would diminish urban redevelopment and would inhibit repositioning of major commercial real estate assets in Hawaii. The magnitudes of adverse impacts for Hawaii construction are suggested by imagining that Waikiki Beachwalk, Ala Moana Center, and International Market Place had not been redeveloped by REITs. These projects are only highlights in potentially foregone recent construction of at least several billion dollars—around twice that much in overall economic activity— if Hawaii's state tax environment already had been made more hostile to REITs. Imagine what could have happened but never will in the future, if Hawaii doubly taxes future REIT income. By giving financial capital an incentive to flow *away* from Hawaii, eliminating the dividends paid deduction for REITs in Hawaii unambiguously would make the Hawaii economy and its residents worse off.

Appendix I

Umbrella Partnership REITs (UPREITs)

Like most other real estate owners, many of the almost 200 publicly traded REITs hold all of their assets through an operating partnership (OP), the majority of the interests of which are held by the REIT. These REITs are known as umbrella partnership REITs or UPREITs.

An UPREIT generally consists of a publicly traded REIT that owns substantially all of its assets and conducts substantially all of its operations through an OP. As a general rule, the REIT will own a number of "common units" in the OP equal to the number of shares of common stock that the REIT has outstanding. In addition, if the REIT has preferred stock outstanding, the REIT will own "preferred units" in the OP that correspond to the shares of preferred stock that the REIT has outstanding.

The limited partnership interests held by partners in the OP other than the REIT also are denominated as "units." Because the REIT owns substantially all of its assets and conducts substantially all of its operations through the OP, and because the REIT owns a number of OP units equal to the number of shares of common stock that it has outstanding, there is effectively an economic identity of interest between the units in the OP that are owned by the outside limited partners and the shares of common stock outstanding in the REIT.

Typically, the REIT acquires its interest in the OP in one of two ways, both evidencing a substantial equity investment in the OP. First, the REIT may sell its shares in an initial public offering and contribute the cash proceeds to the OP. Alternatively, the REIT may contribute real property or partnership interests in partnerships that own real property to the OP. Then, the REIT (or a subsidiary) typically acts as the sole general partner of the OP, and has the exclusive right to manage the affairs of the OP, subject to limitations intended primarily: 1) to preserve the effective economic identity of interest that exists between the units and the REIT shares, and, 2) to avoid the REIT or OP taking actions that would eliminate or adversely affect the redemption/exchange right for unitholders described below.

The third party unitholders typically acquire their interests in the OP in one of two ways: either by i) contributing their direct interests in real property to the OP in exchange for OP units, or, ii) by contributing their interest(s) in pass through entities that own real property to the OP in exchange for OP units.

If new partners are admitted to the OP, the REIT's interest in the OP diminishes over time, typically not below 50%. Conversely, as a REIT issues secondary offerings and contributes cash to the OP (probably the norm), the REIT's interest in the OP increases. The REIT's interest also may increase as unitholders exercise their redemption/exchange rights described below.

The first reported UPREIT transaction was that of Taubman Centers, Inc. in 1992. Currently, based on equity market capitalization, over 60% of the publicly traded REITs are UPREITs.

The UPREIT structure was developed to facilitate the desire of real estate owners to be able to access the public capital markets through the flow-through structure commonly used in the real estate industry while deferring the immediate recognition of taxable gain that would result if they were to transfer their properties or property-owning partnership interests directly to the REIT in exchange for REIT shares, rather than to the OP in exchange for units.

Appendix II

Biography

Paul H. Brewbaker, Ph.D., is principal of TZ Economics, a Hawaii consultancy. Dr. Brewbaker was formerly Chief Economist and Senior Vice President at Bank of Hawaii, where he worked for more than 25 years. He earned his Ph.D. in Economics at the University of Hawaii, Manoa, did graduate work in Economics at the University of Wisconsin—Madison, and received his undergraduate degree in Economics at Stanford University. A frequent university lecturer through the years, Brewbaker was an inaugural recipient of the Certified Business Economist (CBE) designation by the National Association for Business Economics (NABE), in 2015.

HAWAII REGIONAL COUNCIL OF CARPENTERS

February 9, 2017

Statement of the Hawaii Regional Council of Carpenters – IN OPPOSITION H.B. 1012/S.B. 1228

Dear Chair and Members of the Committee:

In 2015, REIT owned projects supported more than 11,700 jobs and $95 million in tax revenue for the state. Hawaii has been fortunate that REIT investment has brought capital into the State to move projects forward that otherwise have lagged for many years.

REITs have helped to support Hawaii's booming construction industry through various projects statewide, including the International Marketplace, Ala Moana Center and Moanalua Hillside Apartments, an affordable housing rental project.

REITs represent affordable housing developments, health care facilities, office building, shopping centers and hotels. REITs have also provided more than 2,000 rental housing units for Hawaii's families and, with the housing shortage, these units are important for our community.

Many of our union contractors work regularly with REITs on developing various projects in various industries that all help to benefit our community, provide jobs for our members and boost our economy.

If this proposed legislation were to pass, it could have the unintended consequence of discouraging future investment in Hawaii. This would ultimately impact jobs, reduce tax revenue and have significant consequences.

Thank you for the opportunity to voice our concerns.

STATE HEADQUARTERS & BUSINESS OFFICES

OAHU: 1311 Hougtailing Street, Honolulu, Hawaii 96817-2712 • Ph. (808) 847-5761 Fax (808) 841-0300
HILO OFFICE: 525 Kilauea Avenue, Room 205, Hilo, Hawaii 96720-3050 • Ph. (808) 935-8575 Fax (808) 935-8576
KONA OFFICE: 75-126 Lunapule Road, Kailua-Kona, Hawaii 96740-2106 • Ph. (808) 329-7355 Fax (808) 326-9376
MAUI OFFICE: 330 Hookahi Street, Wailuku, Maui 96793-1449 • Ph. (808) 242-6891 Fax (808) 242-5961
KAUAI OFFICE: Kuhio Medical Ctr. Bldg., 3-3295 Kuhio Hwy., Suite 201, Lihue, Kauai 96766-1040 • Ph. (808) 245-8511 Fax (808) 245-8911

February 7, 2017

Representative Tom Brower, Chair
Representative Nadine K. Nakamura, Vice Chair
House Committee on Housing

Comments and Concerns in Strong Opposition to HB 1012, Relating to Real Estate Investment Trusts (REITs); Disallows Deduction for Dividends Paid.

Thursday, February 9, 2017, 9:00 a.m., in Conference Room 423

The Land Use Research Foundation of Hawaii (LURF) is a private, non-profit research and trade association whose members include major Hawaii landowners, developers and a utility company. LURF's mission is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources, and public health and safety.

HB 1012. The purpose of this bill is to temporarily disallow the deductions for dividends paid by real estate investment trusts for a period of fifteen years, but with an exception for dividends generated from trust-owned housing that is affordable to households with incomes at or below two hundred per cent of the median family income, as determined by the United States Department of Housing and Urban Development. Should HB 1012 be adopted, for a period of fifteen years, REITs will be taxed on their net income in Hawaii, while REIT shareholders will continue to be taxed on dividend income received, resulting in a double tax.

LURF's Position. LURF acknowledges the intent of this and prior, similar iterations of this measure given what may be perceived to be the potential for tax avoidance and abuse by foreign/mainland corporations and wealthy individuals through real estate ownership arrangements structured through REITs, however, stated justifications for this bill have not been proved or supported by any credible facts or evidence.

The State's Final Report Has Failed to Validate the Alleged Purpose of, and Need for this Proposed Legislation.

Given that an unwarranted change of a universal tax rule in place since 1960 could undoubtedly affect investments made by REITs in Hawaii, significantly reduce the availability of capital in this State, as well as result in other economic repercussions, the Legislature determined in 2015 that it was necessary and prudent to require support for

this type of measure prior to considering its passage. Thus, Act 239, Session Laws of Hawaii 2015, was passed which required the State Department of Business, Economic Development & Tourism (DBEDT) and the State Department of Taxation (DOTAX) to study the impact of REITs in Hawaii, and to present material facts and evidence which could show that such proposed legislation is in fact needed, and whether the State's economy will not be negatively affected because of taking the action proposed.

An interim report was released in December 2015 (the "Interim Report"),[1] followed by a final report issued in September 2016 (the "Final Report"),[2] however, even the Final Report appears preliminary at best; is based on assumptions and estimates; relies on inconclusive results of surveys admittedly taken with a small sample size and low response rate; and is fraught with uncertainties, inconsistencies and weighting errors, making it unfeasible and ill-advised to rely upon for presenting any conclusive calculations or impacts.

Inquiries which critically must be, yet have not been proficiently or accurately addressed in the Final Report, include the amount of income the State would in fact receive as a result of the proposed legislation,[3] especially given the likelihood that REIT investment in Hawaii will in turn decline (i.e., whether the proposed measure is fiscally reasonable and sound); and whether it would be possible to replace the billions of dollars in investments currently being made by REITs should they elect to do business elsewhere if this proposed legislation is passed.

Incredibly, the current version of this HB 1012 nevertheless relies on obscure findings contained in the Final Report, including an unsupported estimate by the DBEDT that in 2014, the deduction resulted in $36,000,000 in corporate income tax revenue being foregone, whereas the Interim Report included an express finding by DBEDT and DOTAX that the corporate income tax forgone was estimated to be $16.3 million (at best) for the same year.[4] No reliable basis or support whatsoever has been presented in this bill to explain the approximately $20,000,000 increase in the estimate previously reported by DBEDT. Moreover, the Final Report fails to include credible information regarding the amount of retail sales generated, and other positive economic contributions and impacts made by REITs in Hawaii which would effectively offset the tax revenue, if any, reportedly forgone by the State.

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[1] Department of Business, Economic Development & Tourism Research and Economic Analysis Division. *Real Estate Investment Trusts in Hawaii: Preliminary Data and Analysis - Interim Report*. December 2015.

[2] Department of Business, Economic Development & Tourism Research and Economic Analysis Division. *Real Estate Investment Trusts in Hawaii: Analysis and Survey Results*. September 2016.

[3] LURF understands that even the State DOTAX does not know how much tax income the government might receive as a result of the proposed legislation.

[4] This unsupported new "estimate" is included in HB 1012 despite the previous express findings of DBEDT and DOTAX that the corporate income tax which the State could potentially forgo was estimated to be $16.3 million (which was the maximum amount within the range estimated) in 2014. *Interim Report*, pp. 3, 20-21, 23.

Given the inaccuracy and unreliability of the tenuous findings contained in the Interim and Final Reports, as well as the complete failure of said Reports to come to any meaningful and valid conclusions required to be made pursuant to Act 239, it should be brought to this Committee's attention that another study on the economic impacts of REITs in Hawaii dated December 2015, was prepared by economic expert Paul H. Brewbaker, PhD., CBE for the National Association of Real Estate Investment Trusts (the "Brewbaker Study").[5] The Brewbaker Study concludes that the repeal of the dividend paid deduction (DPD) for REITs in Hawaii would likely result in a net revenue loss to the State due to a number and combination of negative consequences which would be experienced by the local economy.

In view of the inconsistency between findings contained in the Final Report and the Brewbaker Study, LURF believes it would be irresponsible for this Committee to consider, let alone support HB 1012 which may potentially stifle, if not reverse the current growth of the State's economy, in reliance solely upon the untenable findings of the Final Report, and must respectfully urge this Committee to at the very least, conduct an independent investigation and analysis of all the available facts and information relating to the disallowance of the DPD, and the potential financial and economic consequences thereof, prior to making any decision on this bill.

In view of the inability of the Final Report to conclusively support the validity of this measure, LURF must oppose HB 1012 based on the following reasons and considerations:

1. **The "Double-Tax" Resulting from this Proposed Measure is Contrary to the Underlying Intent of REITs.**

REITs are corporations or business trusts which were created by Congress in 1960 to allow small investors, including average, every day citizens, to invest in income-producing real estate. Pursuant to current federal and state income tax laws, REITs are allowed a DPD resulting in the dividend being taxed a single time, at the recipient level, and not to the paying entity. Most other corporations are subject to a double layer of taxation – on the income earned by the corporation and on the dividend income received by the recipient.

Proponents of this measure attempting to eliminate the DPD, however, appear to ignore that the deduction at issue comes at a price. REITs are granted the DPD for good reason - they are required under federal tax law to be widely held and to distribute at least 90% of their taxable income to shareholders,[6] and must also comply with other requirements imposed to ensure their focus on real estate. In short, REITs earn the DPD as they must comply with asset, income, compliance and distribution requirements not imposed on other real estate companies.

[5] Paul H. Brewbaker, Ph.D., CBE. *Economic Impacts of Real Estate Investment Trusts in Hawaii*. December 2015.

[6] The State of Hawaii thus benefits from taxes it collects on dividend distributions made to Hawaii residents.

According to the Brewbaker Study, repealing the DPD for REITs would subject Hawaii shareholders to double taxation and may reduce future construction and investment by REITs locally, thereby resulting in revenue loss to the State.[7] Moreover, replacement investor groups may likely be tax-exempt institutions such as pension plans and foundations which would generate even less in taxes from their real estate investments.[8]

2. HB 1012 is Contrary to the Tax Treatment of REITs Pursuant to Current Federal Income Tax Rules and Laws of Other States with an Income-Based Tax System.

HB 1012 would enact serious policy change that would create disparity between current Hawaii, federal, and most other states' laws with respect to the taxation of REIT income.

The laws of practically every state with an income-based tax system now allow REITs a deduction for dividends paid to shareholders.[9] Hawaii, as well as other states which impose income taxes currently tax REIT income just once on the shareholder level (not on the entity level), based on the residence of the shareholder that receives the REIT dividends and not on the location of the REIT or its projects.

By now proposing to double tax the REITs that do business in Hawaii as well as their shareholders, HB 1012 would upset the uniformity of state taxation principles as applied between states. Other states which have similarly explored the possibility of such a double tax over the past years have rejected the disallowance of the DPD for widely held REITs.

Passage of this measure and the disallowance of the DPD would make Hawaii and New Hampshire the only two states to double tax widely held REITs as described above, despite the REITs continuing to be compelled to distribute their taxable income to shareholders as mandated by federal law.

3. Hawaii REITs Significantly Contribute to, and Benefit the Local Economy.

Elimination of the DPD would result in a double taxation of income for Hawaii REITs which would certainly mitigate, if not extinguish interest and incentive in investing in Hawaii-based REITs, which currently contribute significantly to Hawaii's economy.

Results from the Final Report indicate that as of September 2016, approximately 42 REITs operating in Hawaii reportedly held assets in the amount of an estimated $7.8 billion at cost basis[10], which has resulted in substantial economic activity in local

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[7] *Brewbaker Study* at pp. 1, 32, 38.

[8] *Id.*

[9] New Hampshire is reportedly the only state which imposes corporate income tax on widely-held REITs, however, while New Hampshire's Gross State Product is comparable to Hawaii's, REIT investment there amounts to only about twenty-five percent (25%) of that in this State.

[10] *Final Report* at pages 3, 15-16.

industries including construction, retail, resort, healthcare and personal services, as well as employment for many Hawaii residents, and considerable tax revenues for the state and city governments. Such tax revenues include State General Excise Tax (GET) on rents and retail sale of goods, business income tax on profits made by tenants, income tax from employment of Hawaii residents, and millions of dollars in property taxes.

Proponents of this bill should be mindful that significant economic growth experienced in this State over the past few years, and which is expected to continue in the future, is undoubtedly attributable in part to REIT investment in Hawaii. Outrigger Enterprises partnered with REIT American Assets Trust to successfully develop the Waikiki Beach Walk. General Growth' Properties' expansion and renovation of the Ala Moana Shopping Center, as well as its partnering with Honolulu-based, local companies (The MacNaughton Group, The Kobayashi Group and BlackSand Capital) to develop the Park Lane residential condominium project is another example. The capital invested in that project to construct additional retail space and luxury residences will reportedly exceed $1 billion, and the development will have created an estimated 11,600 full- and part-time jobs and over $146 million of state revenue. Taubman Centers, Inc., another REIT, also partnered with CoastWood Capital Group, LLC to revitalize Waikiki through the redevelopment of the International Market Place at a cost of approximately $400 million.

REIT projects have helped to support Hawaii's construction industry immensely[11] by providing thousands of jobs, and continue to significantly contribute to the local economy through development of more affordable housing (more than 2,000 rental housing units for Hawaii's families, such as the Moanalua Hillside expansion of more affordable housing rentals), student housing near the University of Hawaii, health care facilities, offices, shopping centers (Pearlridge Center renovations), and hotels.

Despite claims made by detractors, the multi-billion dollar investments and contributions to Hawaii's economy made by REITs may not be so easily generated through other means or resources. Attracting and obtaining in-state capital for large projects is very difficult. The State should also be concerned with the types of entities willing and able to invest in Hawaii, and should be wary of private investors looking only to make quick gains when the market is booming. Because federal regulations preclude REITs from "flipping" properties, REITs are by law, long-term investors which help to stabilize commercial real estate prices, and which are also likely to become a part of the local community.

[11] In the past five years, REIT-related construction activity alone is estimated to have generated $3 billion in Hawaii GDP.

4. The Tax Rule Changes Proposed by this Bill will Unfairly Affect REITs and the Small Investors Which Have Already Made Substantial Investments in Hawaii.

The disallowance of the DPD and resulting increased taxation of REITs will reduce investment returns as well as dividend payments to shareholders, which will no doubt have a significant negative effect on future investment by REITs in Hawaii.

Proponents of this bill attempt to minimize the negative consequences of disallowing the DPD by claiming that very few Hawaii taxpayers invest in REITs with property in Hawaii, however, LURF understands that in 2014 over 9,000 Hawaii investors had investments in over 70 public, non-listed REITs and received almost $30 million in distributions, and that tens of thousands more directly or indirectly own shares in stock exchange-listed REITs.

Supporters of HB 1012 also ignore the fact that tax law changes proposed by HB 1012 will unfairly impact those publicly traded REITs which have already made substantial investments in Hawaii and have contributed greatly to the State's economy in reliance on the DPD, which, as discussed above, is considered a fundamental principle of taxation applicable to REITs.

If passed, this measure would strongly discourage future investment by REITs in Hawaii, which would ultimately impact jobs, reduce tax revenue and result in significant consequences for the State's future economy.

Conclusion. LURF's position is that the findings of the Final Report have failed to credibly present any material facts or circumstances to prove that this proposed legislation is in fact necessary, or that the State's economy will significantly improve because of taking the action proposed. The intent and application of HB 1012 thus arguably remain unreasonable, unwarranted, and exceedingly anti-business.

Act 239, SLH 2015 was specifically enacted by the State Legislature to validate the alleged purpose of this bill, and the results of the Final Report were considered vital to confirm the need for this type of measure. Therefore, based on the inability of said Report to convincingly and conclusively determine that the State's economy will be negatively impacted as a result of the action proposed, or that this proposed legislation is otherwise warranted, and given that an unjustifiable change of a universal tax rule in place since 1960 could significantly reduce the availability of capital in this State, as well as result in other negative economic repercussions, LURF must **strongly oppose HB 1012**, and respectfully requests that this bill be **held in this Committee.**

February 7, 2017

Honorable Tom Brower, Chair
Honorable Nadine Nakamura, Vice Chair
Committee on Housing
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to HB 1012, Relating to REIT

Chair Brower, Vice Chair Nakamura, and Committee Members:

The Kobayashi Group, The MacNaughton Group, and BlackSand Capital, are three generations of families in the building industry development, construction, and investors in Hawaii. We are fully engaged and understand the economics of REIT investments and strongly oppose to House Bill 1012.

It is paramount to understand the Congressional legislative intent when the Real Estate Investment Trusts (REIT) was enacted in 1960. This legislation provided an opportunity for small investors to invest in large-scale diversified portfolios of income producing real estate provided that at least 90% of their taxable income is distributed to the investors.

Proponents of HB 1012 have not provided rational justification for the paying of double taxes on the REIT revenues and distribution. There is no "tax loophole" to close. How many public and private companies that you know must distribute a minimum of 90% of their taxable income to their shareholders?

HB 1012 states in part, ". . . repealing the current deduction would promote fairness in the treatment of similar, but differently organized, business entities and would generate additional revenue for state program." If the assumption that REITs were enjoying a tax loophole, don't you think that many Hawaii businesses would have reorganized to become a REIT?

The State DBEDT produced a study, "Real Estate Investment Trusts in Hawaii: Analysis and Survey Results," dated September 2016. Statistically, the data was not quantifiable as the information was not readily available and therefore, assumptions were used.

The report failed to include in their focus the tangible tax benefits generated to the State and Counties. REIT investments have and continue to be a quantifiable financial benefit to the State of Hawaii and County governments in the form of collecting millions of dollars in

State GET, real property assessments, transfer fees from REIT sales, and shareholders income tax on the distribution. REIT investments in Hawaii employ thousands of residents in the construction trade crafts, hospitality industry, retail shops, healthcare, financial institutions, among other jobs. REITs build, renovate, and upkeep their properties at investors expense.

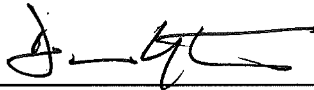
It is incorrect that Hawaii taxpayers subsidize the cost of infrastructure when they must pay impact fees.

The question becomes—can the State of Hawaii financially afford to diminish the presence of REITs in Hawaii? Look around Hawaii and you will be pleasantly surprised that many of the large scale projects such as storage facilities, office buildings, hospitality properties, residential housing, and shopping centers would <u>not</u> have been built without REITs.

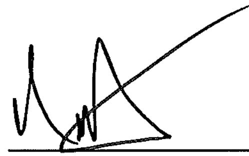
We strongly urge you to oppose HB 1012.

Sincerely,

KOBAYASHI GROUP
Bert Kobayashi,
Senior Advisor



THE MACNAUGTON GROUP
Duncan MacNaughton,
Chairman



BLACKSAND CAPITAL
Ian MacNaughton,
Co-Founder & Managing Partner

BLACKSAND CAPITAL
BJ Kobayashi,
Co-Founder & Managing Partner

Testimony of
Christopher Delaunay
Pacific Resource Partnership

HOUSE OF REPRESENTATIVES
THE TWENTY-NINTH LEGISLATURE
REGULAR SESSION OF 2017

COMMITTEE ON HOUSING
Representative Tom Brower, Chair
Representative Nadine K. Nakamura, Vice Chair

NOTICE OF HEARING

DATE: Thursday, February 9, 2017
TIME: 9:00am
PLACE: Conference Room 423

Aloha Chair Brower, Vice Chair Nakamura, and Members of the Committee:

We respectfully **oppose** HB 1012, Relating to Real Estate Investment Trusts (REITs) , which temporarily disallows the deduction for dividends paid by real estate investment trusts for a period of 15 years, but with an exception for dividends generated from trust-owned housing that is affordable to households with incomes at or below 200% of the median family income.

REITs are required by federal law to be long-term investors. In Hawaii, REITs have brought stability as well as substantial economic growth to local industries in Hawaii including commercial real estate, construction, retail, healthcare, visitor industry and affordable housing. In 2015, REITs supported more than 11,700 jobs and provided $95 million in tax revenue for the state. Hawaii has been fortunate that REIT investment has brought capital into the State to move projects forward that otherwise have lagged for many years. If this proposed legislation were to pass, it would strongly discourage future investment by REITs in Hawaii. This would ultimately impact jobs, reduce tax revenue and have very significant consequences for future projects.

For the reasons mentioned above, we respectfully request that HB 1012 be held in Committee. Thank you for the opportunity to share our comments on this important issue with you.

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(Continued From Page 1)

About PRP

Pacific Resource Partnership (PRP) is a not-for-profit organization that represents the Hawaii Regional Council of Carpenters, the largest construction union in the state, and more than 240 of Hawaii's top contractors. Through this unique partnership, PRP has become an influential voice for responsible construction and an advocate for creating a stronger, more sustainable Hawaii in a way that promotes a vibrant economy, creates jobs and enhances the quality of life for all residents.

702 Kanaha Street
Kailua, HI 96734

808-221-5955
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February 7, 2017

HOUSE OF REPRESENTATIVES
THE TWENTY-NINTH LEGISLATURE
REGULAR SESSION OF 2017

COMMITTEE ON HOUSING
Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Representatives Aquino, Buenaventura, Hashem, McDermott and Quinlan

RE: **Testimony in Support of HB 1012 – Relating to Real Estate Investment Trusts**
Hearing: Thursday, February 9, 2017, 9:00 am; Room 423
Location: Hawaii State Capitol, 415 South Beretania Street

Aloha Chair Brower, Vice Chair Nakamura and members of the Committee,

My name is Michael Steiner and I am the principal of Steiner & Associates, a consulting firm. As the former Executive Director of Citizens for Fair Valuation, I have worked for many years to bring equity to lessees and the State of Hawaii when dealing with Real Estate Investment Trusts (REITs).

I strongly support HB 1012 which, with certain exceptions, will temporarily disallow the deduction for dividends paid by real estate investments trust for a period of 15 years. REITs are earning tremendous profits in Hawaii without paying any state income tax. While using Hawaii's roads, schools and other general services, much of the REIT revenue generated within the state of Hawaii leaves our shores providing little economic value to the state or other businesses.

HB 1012 is designed to help support the State of Hawaii and its citizens by requiring REITs to pay their fair share of services used via a state income tax. It is estimated the state would receive between $30 and $60 million annually in funds which are desperately needed to support and maintain our security, infrastructure, education, social services and government.

With the current pace of building and improvements, REITs will continue to invest in Hawaii as the overall cost of this proposed tax is only 6.4% - a relatively small price to pay in exchange for using our roads and sewers.

There is no reason why a REIT in Hawaii should be operating tax-free when our state is struggling to meet its commitments. REITs simply do not contribute a fair share to support their existence in Hawaii.

It is time to take a stand and require REITs to contribute to the general economy.

Please protect the health of our Hawaii community and pass HB 1012.

Mahalo nui loa.

Michael Steiner

Michael Steiner, CLM, Principal
Steiner & Associates

February 7, 2017

State Capitol
Representative Tom Brower
Chair, Committee on Housing
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill 1012 relating to Real Estate Investment Trusts

Dear Representative Brower and Members of the Committee on Housing,

We are submitting this testimony in opposition to House Bill 1012 on behalf of The Shidler Group which is based in Honolulu and invests in the formation and capitalization of real estate-related companies and new investment initiatives, including the acquisition and ownership of individual properties and portfolios. The Shidler Group has created real estate investment trusts (REITs) that have invested in Hawaii and in the Mainland including Pacific Office Properties which is headquartered in Honolulu.

This bill is very similar to bills introduced last year to eliminate the dividends paid deduction for public REITs. The proponents of taxing REITs focus on two things. First, there is a tax loophole that allows REITs to avoid paying corporate income tax to the State of Hawaii that needed to be closed – there is an injustice that needs to be fixed. Second, in addition to the fairness argument, the proponents believe that the legislators, in these tough economic times, should be doing everything possible to increase tax revenue.

First, we don't believe that the way REITs are taxed should be considered a so-called "loop hole." You have to consider Congress' motive for enacting this legislation back in 1960. Historically, commercial real estate in the United States has been owned by partnerships, or tax exempt institutions such as pension funds and foundations. Partnerships pay no income tax, income is only taxed at the partner level. However, a corporation is required to pay income tax at the corporate level and then the shareholders also pay tax on the dividends they receive. Therefore, corporations were at a distinct disadvantage to these other ownership structures when competing for the same assets. By providing a tax deduction for dividends paid to shareholders (unlike regular corporations), taxable income is eliminated as long as the REIT is paying dividends equal to or greater than its taxable income. This allows a REIT to operate for tax purposes like a partnership. This also allows capital to be raised in regulated public markets for real estate investment and provides a way for small investors to invest in commercial real estate projects.

Second, the proposed legislation in unlikely to generate anywhere near the estimates from the study commissioned by DBEDT. Most states, including Hawaii, require corporations with operations in many states to use a 3-factor formula based on property owned in the state, payroll in the state, and sales in the state to determine how much of their worldwide taxable income will be apportioned to the state. You cannot estimate the tax revenue by multiplying the gain on the sale of an asset located in Hawaii by the corporate tax rate.

Third, the DBEDT study completely underestimates the enormous amount of additional GET revenue that has resulted from REIT investment in Hawaii. The study estimates that REITs generate $200 million per year in revenue. However, this does not include the GET paid on the construction of the Ala Moana Shopping Center and International Marketplace projects plus the additional GET on rental revenue – this alone would dwarf the potential additional corporate income tax revenue that would be raised from taxing REITs.

Fourth, additional tax revenue, if any, will only be generated if this proposed legislation does not change the behavior of REITs operating in Hawaii. The underlying assumption is that REITs will just absorb this additional cost. We believe the more likely outcome is that they will divest themselves from their Hawaii assets over time and/or not make future investments in Hawaii. If that is correct, the commercial properties will likely go back to being owned by partnerships and tax-exempt entities that pay no income tax to Hawaii. We will have lost the benefits that resulted from REIT investment in return for nothing.

States and municipalities across the country have offered corporations long-term tax breaks to attract investment and the jobs and tax revenues that result from that investment. Hawaii has not had to do that. REITs have invested in Hawaii and we have benefited from that investment. But, we now have proposed legislation would eliminate the dividends paid deduction for a 15-year period, with an exception for income derived from affordable housing (we also believe it will be extremely difficult and costly to calculate the taxable income that would qualify for the exemption). Changing the rules after someone has already made a significant investment is simply bad public policy. How confident would you be in investing in Hawaii after we change the rules after the fact and join New Hampshire to be the only two states in the country taxing REITs?

Hawaii is in an enviable position. We are already attracting the capital investment. That investment is creating predictable tax revenues and jobs. In 2015, corporate income tax represented one-half of one percent of the total tax revenue for the state. It is uncertain whether this legislation will actually increase corporate tax revenue, but supporters of this legislation are willing to risk all the benefits we have derived from REIT investment in the hope of generating a negligible amount of additional tax revenue. It is analogous to risking $10 to get an extra $1 - that is a very poor risk/reward trade off.

On the surface, the sentiment of this legislation sounds simple and fair - "REITs should pay taxes like everyone else." But, it's not that simple. How fair is it to eliminate the opportunity for small investors to invest in commercial real estate? Most commercial property owners do not pay income tax and they aren't bringing operational expertise and the job creation that REITs do either. Why should we give them a competitive advantage against REITs? Calculating and tracking the additional revenue generated from this legislation will be far from simple. Hawaii stands to lose much more than we could possibly gain by passing this legislation. We urge you to not support this legislation.

Sincerely,

Lawrence J. Taff

Jay H. Shidler

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Mr. & Mrs. Jonathan Hughes
808-596-2661

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Sincerely,

Mr. & Mrs. Jonathan Hughes

Kent Mori Walther
Honolulu, Hawaii

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

February 7, 2017

RE: Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill closes an unfair loophole in our state income tax law that allows mainland corporations operating as REITs in Hawaii to avoid paying Hawaii state income taxes on the net income they generate within our state, resulting in a total loss to the state of $30 to $60 million annually. All of us as residents of Hawaii are left to subsidize the loss of these foregone funds that are so desperately needed to support the costs of education, social services, and other state commitments.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base and increase the tax burden upon all other non-REIT property owners in the state. The value of REIT property in Hawaii is currently estimated to be approximately $16 billion, and includes some of the largest commercial properties in the state such as Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, among hundreds of others. These mainland REIT-owned properties operate here and benefit from the tax-funded services provided by the state, without paying any of the income tax that non-REIT property owners must pay. This loophole must be closed to level the playing field so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Sincerely,

Kent Mori Walther

From: James K. Tam <JKTam@Lawcsilc.com>
Sent: Tuesday, February 7, 2017 2:44 PM
To: HSGtestimony
Subject: H.B. No. 1012/ Testimony in Support

February 7, 2017

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Dear Representative Brower:

This email is sent in support for H.B. No. 1012, Relating to Real Estate Investment Trusts

Hearing is scheduled for Thursday, February 9, 2017

As a resident concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill will fix a loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This loophole results in a loss in tax revenue of $30 to $60 million annually to the State. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle without enough financial support.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. H.B. No. 1012 will fix this loophole so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

James Kellett Tam
841 Bishop Street, Suite 850
Honolulu, Hawaii 96813
808-522-5134
jktam@lawcsilc.com

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Ken Matsuura
215 N. King Street, Suite 1000
Honolulu, Hawaii 96817

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors in Hawaii.

For the foregoing reasons, I urge the committee to pass H.B. No. 1012. Mahalo.

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Chad Miller
2047 Nuuanu Ave #1301
Honolulu, HI 96817

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

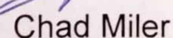
As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Best regards,



Chad Miler

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Larry Busto
500 Ala Moana Blvd., #2-303, Honolulu, HI. 96813 (808)-534-7301

Thursday, February 9, 2017

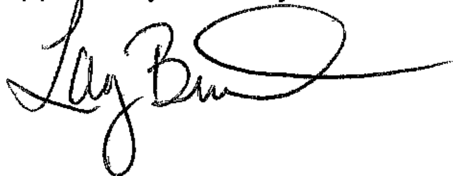
Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.



Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Steven Gold
91-1055 Waikai St Ewa Beach HI 96706 (808-864-6426)

Tuesday, February 7, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments. As a State, we continue to struggle with covering our expenses, continually searching for new sources of revenue that may burden our already high tax rate.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate in our State without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors are taxed.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Ritchie Mudd
4720 Halehoola Place
Honolulu..HI 96816

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

I am a concerned citizen and I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

Simply..Our State badly needs more funds for Education Social services and Infrastructure...

This bill is fair and equalizes. tax issues for our local business people.

This bill will not raise taxes on our residents but collect much needed revenue from those who have taken advantage far too long of this Loophole..

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Mahalo for your consideration

Ritchie Mudd

808 255 9995

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Bennett Walin
2145 Wells St #105
Wailuku HI 96793

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a small business person in the real estate industry and a long term resident, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

Why are we, the local people continually subsidizing the monster corporations.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

William Crowe (B)
115 D Maunalua Ave., Honolulu HI
96821

Thursday, February 9, 2017

Support for H.B. No.1012, Relating to Real Estate Investment Trusts

As a business person and real estate broker concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take their net income out of our state without paying income tax or gains tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearl ridge Shopping Center, Hilton Hawaiian Village, International
Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Rep. Tom Brower, Chair
Rep. Nadine Nakamura, Vice Chair
Committee on Housing

Vivian Shiroma
302 Anonia Street, Honolulu, HI 96821
(808) 373-1028

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

I am not a real estate investor. I am just one of the many hard-working, middle-income residents of Hawaii who has always paid out a large share of my earnings for various taxes, and for whom there are no loopholes to reduce my tax bill. I support H.B. No. 1012, Relating to Real Estate Investment Trusts.

The State needs more money for rail, public education, services for the growing elderly population, support of nonprofit community organizations, aid for the homeless, and endless other projects. Why is it that middle class taxpayers always seem to be asked to bear the financial burden? The costs of raising and educating our children, maintaining a home and caring for our parents have tapped us out. We have no way to save for retirement and are worried we may never pay off the large mortgages we carry into our 60’s and 70’s. These challenging economic times call for creative measures.

H.B. 1012 is a great idea and merits continued action. It would make revenues generated in Hawaii stay in Hawaii instead of going to other states. It would make mainland corporations compete more fairly with local real estate investors. It would leverage Hawaii’s geographic and cultural attractions to benefit the people like me, for whom no place else can be called home. And it could be a new source of millions of dollars of income annually to the state, for as long as these companies continue to do business in Hawaii.

Please pass H.B. 1012. On behalf of all the tax-burdened, working class people in Hawaii, thank you for your consideration.

Rochelle N. Ito
41-860 Kakaina Street
Waimanalo, Hawaii 96795

February 8, 2017

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Re: Support for H.B. No. 1012, Relating to Real Estate Investment Trusts
Hearing Date: Thursday, February 9, 2017

Dear Representative Brower, Nakamura and Housing Committee:

As a resident of the state of Hawaii, I'm concerned about our economy and long-term community development, therefore, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts (REITs).

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us, which in my opinion, doesn't seem fair. This results in a loss of $30 to $60 million annually to the state. These funds could be used to greatly support Hawaii residents with costs like education, social services, and other state commitments that continue to struggle. My understanding is that there are more REIT-owned properties in Hawaii per capita than any other state in the nation! With our attractive real estate market, this will likely increase in the future resulting in an even greater loss of funds that could be used to support our state and Hawaii's people.

Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion because hundreds of properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For the above-mentioned reasons, I urge the committee to pass H.B. No. 1012.

Thank you for the opportunity to testify.

Sincerely,
Rochelle N. Ito

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Ritchie Mudd
4720 Halehoola Place
Honolulu..HI 96816

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

I am a concerned citizen and I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

Simply..Our State badly needs more funds for Education Social services and Infrastructure...

This bill is fair and equalizes. tax issues for our local business people.

This bill will not raise taxes on our residents but collect much needed revenue from those who have taken advantage far too long of this Loophole..

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Mahalo for your consideration

Ritchie Mudd

808 255 9995

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Bennett Walin
2145 Wells St #105
Wailuku HI 96793

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a small business person in the real estate industry and a long term resident, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

Why are we, the local people continually subsidizing the monster corporations.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Gabriel F. Gorman
1088 Bishop Street, Honolulu, HI, 96813

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Michael Reiley
350 Hoohana Street, Kahului, HI 96732

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a Hawaii business owner concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

HSGtestimony

From: janj lau <janjlau@gmail.com>
Sent: Wednesday, February 8, 2017 6:52 AM
To: HSGtestimony
Subject: HB1012

Follow Up Flag: Follow up
Flag Status: Flagged

Janice Lau

janjlau@gmail.com

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a lifetime resident of Hawaii I am concerned about Hawaii's economy and long-term community development. I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Janice Lau

From:	Jake Fergus <jake@fergushawaii.com>
Sent:	Tuesday, February 7, 2017 5:39 PM
To:	HSGtestimony
Subject:	Support of H.B. 1012, Relating to Real Estate Investment Trusts
Follow Up Flag:	Follow up
Flag Status:	Flagged

Dear legislators:

I am writing this testimony as a concerned member of the local community who was born and raised in Hawaii. I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts, since it serves the best interests of Hawaii's economy, of long-term community development, and promotes fairness among all taxpayers who currently pay a share of their hard earned money to the State.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Thank you,
Jake Fergus

Jake Fergus
Fergus & Company | 125 Merchant Street, Suite 200 | Honolulu, HI 96813
P: 808.545-1700 Ext. 12 | C: 808.282-5194
F: 808.545-1788 | E: jake@fergushawaii.com

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Bennett Walin
2145 Wells St #105
Wailuku HI 96793

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a small business person in the real estate industry and a long term resident, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

Why are we, the local people continually subsidizing the monster corporations.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Alex Fergus
125 Merchant Street, Suite 200
Honolulu, HI 96813

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts (REITs)

As a business person and community member concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Sincerely,

Alex Fergus

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Francis Imada
(808) 497-6053

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a taxpayer and business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Francis Imada

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

FRANK FARIA
PO BOX 26028
HONOLULU, HAWAII 96825

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

NAIOP

COMMERCIAL REAL ESTATE
DEVELOPMENT ASSOCIATION
HAWAII CHAPTER

February 8, 2017

LATE

Rep. Tom Brower, Chair
Rep. Nadine K. Nakamura, Vice Chair
Committee on Housing
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill No. 1012

Dear Chairman Brower, Vice-Chairman Nakamura, and Committee Members:

Thank you for this opportunity to submit testimony regarding House Bill No. 1012 relating to Real Estate Investment Trusts (REIT).

The Hawai'i Chapter of NAIOP, the Commercial Real Estate Development Association, strongly opposes the passage of H.B. 1012.

NAIOP Hawai'i is one of the state's leading professional organizations dealing with commercial real estate with more than 150 members statewide representing developers, owners, investors, asset managers and other professionals in industrial, office and mixed-use commercial real estate. Our membership includes both REIT and non-REIT organizations.

Our members have first-hand knowledge of the how real estate investment can positively impact our communities and drive our state's economy. Over the last five years, REIT investment has resulted in an estimated $3 billion in construction activity which created thousands of local jobs, both construction and permanent, and helped our community recover from the severe economic downturn that occurred during the mid-2000s.

And REITs have continued to contribute to our community by investing in affordable housing, retail, healthcare, office buildings and other commercial projects that will serve our community and local families for decades to come. In 2015, REIT owned projects supported more than 11,700 jobs and $95 million in tax revenue for the state.

In addition, because of regulatory restrictions, REITs are required to hold their assets for a long time. This means that REITs make long-term investments which provides additional stability to Hawai'i's economy and real estate markets. This type of commitment makes REITs the ideal type of investor that you would want to attract to Hawai'i.

P.O. Box 1601, Honolulu, HI 96806 * Phone (808) 845-4994 * Fax (808) 847-6575

You are well aware of Hawai'i's reputation as a difficult place to do business. And if Hawai'i eliminates the dividends pay deduction (DPD), it would create additional barriers to do business in our state, which would then impact the level of interest in future investment in Hawaii.

This would put our state at an unfair position to compete for capital investment with the other 48 states that do NOT impose double-taxation on REITs.
This is a bad signal to send to the business community and will further harm Hawai'i's reputation, world-wide, as a place to do business. And we respectfully urge you to hold the bill.

Sincerely,

Scott Settle
Board President
NAIOP Hawai'i Chapter

OPSEU Pension Trust
Fiducie du régime de retraite du SEFPO

February 9, 2017

LATE

The Honorable Tom Brower, Chair and Committee Members
Committee on Housing
Hawaii State Capitol
Honolulu, HI 96813

Dear Chair Brower and Committee Members:

My name is Andrew Alcock, Director, Real Estate Investments, OPTrust, testifying in opposition to HB 1012 Relating to Real Estate Investment Trusts ("REIT's"). OPTrust is one of Canada's largest pension funds, with net assets of over $19 billion CAD. The trust administers a defined benefit plan with almost 87,000 members and retirees.

OPTrust partnered with DeBartolo Development ("DeBartolo") to develop the Ka Makana Ali'i center in Kapolei. DeBartolo's vision and partnership with the Department of Hawaiian Home Lands ("DHHL") were important factors in OPTrust's decision to invest in Hawaii. OPTrust's investments are made through a very long vetting process, but more importantly, the investment in Ka Makana Ali'i was made because of the sound investment policies of both the State of Hawaii and its partnerships with private developers like DeBartolo. OPTrust invests across the globe. Many of those investments are made through REIT structures, which provide a dividend exemption by law. The ability to invest in Ka Makana Ali'i through a REIT structure was paramount to OPTrust's decision to invest in Hawaii.

REIT's provide a way to finance projects that local investors or the State of Hawaii would not be able to provide. Eliminating the distribution deduction for REIT's will not provide the income to the State that HB 1012 envisions. Rather, it would be a detriment to the development of many projects such as low-income housing or future commercial developments, because it effectively would prevent investors from making investments in the State of Hawaii. Should HB 1012 be passed, it would no longer be efficient for OPTrust to make investments in the state of Hawaii, including Phase 2 of the Ka Makana Ali'i project. As a result, OPTrust would be forced to invest elsewhere.

We urge you to strongly oppose HB 1012 Relating to REIT's, so that projects such as Ka Makana Ali'i can continue to be built and add to Hawaii's economic growth.

Thank you for this opportunity to testify.

Yours truly,

Andrew Alcock
OPTrust

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Suite 1200
Toronto, ON M5C 3A7

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{00247134.1}

February 8, 2017

LATE

The Honorable Tom Brower, Chair and Committee Members
Committee on Housing
Hawaii State Capitol
Honolulu, HI 96813

Dear Chair Brower and Committee Members:

My name is Rich Hartline, VP Development of DeBartolo Hawaii testifying in opposition to HB 1012 Relating to Real Estate Investment Trusts.

DeBartolo Hawaii was able to develop the Ka Makana Ali'i in Kapolei because of our partnership with a REIT organization. Financing a large project such as Ka Makana Ali'i is difficult. Financing markets, especially for projects in Hawaii is very difficult. Ka Makana Ali'i is a long term project that cost over $500 million to construct. The rent from the center will be used to provide services for native Hawaiians and more importantly, to provide income to DHHL's general budget. Our ability to work with a REIT as a financing tool was very important in the ability for the center to be built. At the time, financing tools for a project of the size of Ka Makana Ali'i were not readily available. The project was able to be built because a REIT was able to see the vision of the second city and the need to help enhance DHHL.

REIT's provide a way to finance projects that local investors or the State would not be able to offer. Taxing REIT's will not provide the income to the state that HB 1012 envisions; rather, it is a detriment to the development of many projects such as low-income housing or future commercial developments to state agencies such as DHHL that is necessary, because it effectively stops investment made to the state by outside investors.

We urge you to strongly oppose HB 1012 Relating to Real Estate Investment Trusts so that projects such as Ka Makana Ali'i can continue to be built and add to Hawaii's economic growth.

Thank you for this opportunity to testify.

841 Bishop Street, Suite 1070, Honolulu, HI 96813 | PH 808.439.8400 | FX 808.439.8409 | www.debartolodevelopment.com

Eric W. Gill, Financial Secretary-Treasurer   Gemma G. Weinstein, President   Godfrey Maeshiro, Senior Vice-President

February 8, 2017

Chair Tom Brower and Members
Committee on Housing, Hawaii State House of Representatives

TESTIMONY submitted on behalf of UNITE HERE! Local 5 in **strong support** of HB 1012
relating to Real Estate Investment Trusts

Chair Brower and Members:

UNITE HERE Local 5 is a local labor organization representing 10,500 hotel, health care and food service workers employed throughout our State. We stand in strong support of HB 1012, relating to Real Estate Investment Trusts ("REITs").

There is no justification for giving REITs like Xenia Hotels & Resorts, the owner of the Aston Waikiki Beach Hotel, a tax advantage over other hotels and commercial real estate investors. For the State to consider giving out tax breaks, we should ensure that those tax breaks are directly tied to some benefit that the State would not otherwise get – and even then, the costs and benefits should be weighed very carefully. What do REITs provide that other real estate owners do not?

HB 1012 corrects an existing loophole in our State income tax law that currently allows corporations like Xenia operating profitably as REITs to take the net income they earn here out of state, tax free. In a report from September 2016, DBEDT estimated that the dividend paid deduction for REITs resulted in a net $35 million loss in potential tax income for the State in 2014.

The fact of the matter is that our State can no longer afford to provide this kind of a tax break to real estate speculators and investors. While we recognize the need for balancing out the interests of private enterprise and business, this bill is about first and foremost protecting the State's financial interests.

Our reality is such that the people of Hawaii are being pushed off our islands, pushed into overcrowded living situations, or pushed onto the streets while paying a disproportionately high percentage of their income in taxes. More and more of our local jobs go to mainland companies while locals struggle to earn a living wage. But Hawaii can be a place for us to continue to work, play and raise our families. Hawaii can support a robust tourism industry with good jobs. Hawaii can be economically sustainable, but we must be willing to hold large banks, developers and REITs accountable to our needs.

We ask for your Committee's support in adopting HB 1012. Thank you.

Thank you.

1516 South King Street • Honolulu, Hawaii • 96826-1912 • Phone (808) 941-2141 • Fax (808) 941-2166 • www.unitehere5.org

3610 Waialae Ave
Honolulu, HI 96816
P: (808) 592-4200
E: tyamaki@rmhawaii.org

TESTIMONY OF TINA YAMAKI
PRESIDENT
RETAIL MERCHANTS OF HAWAII
February 9, 2017

Re: HB 1012 RELATING TO REAL ESTATE INVESTMENT TRUSTS

Good morning Chairman Brower and members of the House Committee on Housing. I am Tina Yamaki, President of the Retail Merchants of Hawaii and I appreciate this opportunity to testify.

The Retail Merchants of Hawaii (RMH) is a statewide, nonprofit trade association committed to the growth and development of the retail industry. Our mission is to promote the welfare of the retail industry, serve as an advocate for the retail industry, and provide information and training to advance the interests of the retail industry.

RMH opposes H.B. 1012 Relating to Real Estate Investment Trusts (REITs), which we believe would have a detrimental effect on Hawaii's retail industry.

Many of Hawaii's shopping destinations are REIT properties and contribute greatly to the retail industry, which employs 148,000 people statewide and generates more than $1.1 billion in GET revenue for the state.

There continues to be strong demand for retail, with new stores and shopping centers opening statewide, as well as investments to renovation or expand existing shopping centers. And many of these are REIT properties, including GGP's Ala Moana Center, Taubman's International Market Place and Washington Prime's Pearlridge Center. These properties have helped to shape Hawaii as a great shopping destination for our visitors, but also provides our local residents with diverse options as well.

In Hawaii, REITs provide more than 5.2 million square feet of retail space and they continue to invest and reinvest in our retail industry providing new and fresh offerings, which benefits our overall economy.
If this bill passes, the potential loss of investment from REITs would have an adverse impact on our retail industry and Hawaii's overall economy.

We respectfully ask that you hold this proposal. Again mahalo for this opportunity to testify.

A RETAIL REAL ESTATE COMPANY

LATE

February 7, 2017

Hearing Date: February 9, 2017
Time: 9 am
Place: State Capital, Conference Room 423

Rep. Tom Brower, Chair
Rep. Nadine K. Nakamura, Vice Chair
Committee on Housing
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: Testimony in Opposition to House Bill No. 1012

Dear Chairman Brower, Vice-Chairman Nakamura, and Committee Members:

Thank you for the opportunity to provide written testimony on House Bill No. 1012, which would disallow the dividends paid deduction for REITs for 15 years unless the REIT is engaged in providing affordable housing. We are Francis Cofran, the Senior General Manager of Ala Moana Center, the largest retail center in the state of Hawaii, and Sandeep Mathrani, the Chief Executive Officer of GGP, Inc. ("GGP"), an S&P 500 publicly traded REIT, an owner of Ala Moana Center.

GGP owns 127 retail properties in 40 states within the U.S. with approximately 121 million square feet of gross leasable space. Our mission is to own and operate best-in-class retail properties that provide an outstanding environment and experience for our communities, retailers, employees, consumers and shareholders. GGP operates three major retail shopping centers in Hawaii - the Prince Kuhio Plaza in Hilo, Whalers Village in Lahaina, and the Ala Moana Center in Honolulu.

The latter two are iconic visitor attractions that help to sustain Hawaii's important tourism industry and also directly benefit our local economy through the Hawaii general excise tax. Consequently, the State of Hawaii directly shares the economic benefit of REIT investments in Hawaii to keep and maintain these iconic visitor destinations as attractive as possible.

In addition to their importance to the tourism industry and the Hawaii economy, these centers have become key gathering places for our local communities because as a REIT we have been able to constantly reinvest and enhance the customer experience. For example, we are very supportive and proud of the activities that take place at the new Center Stage at Ala Moana Center, our sponsorship of the Fourth of July firework celebration, our enhancements at Whaler's Village, and our ability to introduce to Hawaii residents, retailers and retail concepts which are on the cutting edge and brand new to the State of Hawaii. Efficient REIT capital allows us to make infrastructure and other

improvements which set the stage for projects like Shirokiya's Japan Village Walk and Foodland Farms at Ala Moana Center.

In prior year legislative sessions, we have testified in opposition to attempts to eliminate the deduction for dividends paid by REITs. This testimony has focused on the following points:

- If Hawaii enacts this legislation, it will be out of step with all other states with respect to the dividends paid deduction for REITs except New Hampshire, where we believe REIT investment has been inhibited.
- The deduction for dividends paid by REITs results in a single level of taxation at the shareholder level which is consistent with how limited liability companies, Subchapter S corporations and partnerships that own real estate are taxed; changing this puts REITs at a disadvantage in relation to these other forms of doing business.
- REITs produce a substantial level of economic benefits to the state of Hawaii in the form of jobs, general excise tax ("GET"), income tax from persons working or engaging in business at REIT properties, and real property taxes. During 2016, GGP paid $10.3 million in real property taxes with respect to its three Hawaiian properties and $7.9 million in GET taxes on its rents. It is unfathomable that there is a perception that REITs are not investing in the economic wellbeing of the state and its residents.
- During 2012-2016, GGP has invested almost $1 billion in capital to construct additional retail square footage and residential condominiums based on the existing Hawaiian tax regime. During the construction period, we estimated economic activity of 11,600 full- and part-time jobs and over $146 million of state revenue including indirect community benefits. Post construction, the additional retail will produce an incremental $33 million of state revenue and 3,000 jobs annually.
- Future expansion plans could be reconsidered if the attractiveness of investing in Hawaii relative to the rest of the United States is diminished through the enactment of this bill.

In September 2016, the Department of Business, Economic Development & Tourism ("DBEDT") released its final study on REITs in Hawaii. While the report contains some relevant information, the final report merely reflects a historical look at REIT investment. The report specifically notes that the estimates do not take into account changes in behavior, including the likelihood of reduced future REIT investment, if there is an additional impediment to earning a return caused by the lack of a dividends paid deduction. Similarly, the report does not address the revenue loss to the State resulting from future reduced REIT investment.

The DBEDT report finds that the average amount of corporate income tax forgone between 2009-2014 was $9.6 million. It would be imprudent to enact this

A RETAIL REAL ESTATE COMPANY

legislation in hopes of generating such a small amount of tax revenues, while risking billions of dollars of new REIT investments and the hundreds of millions of dollars of state revenues and thousands of jobs that would result from those investments. There has been significant focus that the DBEDT report reflects that for 2014, the amount of corporate income tax estimated to be foregone was $36 million. We believe this was a one-time event and should not be viewed as the normal continuing revenue stream. That is even more obvious when it is eliminated, the average foregone tax revenue drops to $4.3 million and if you double the 2013 foregone tax as a proxy for 2014, the average is $5.3 million. In both instances, a much lesser foregone income stream.

The DBEDT report found that in-state residents in 2014 only paid approximately $1 million of tax that would offset the amount of corporate tax foregone. However, the study neglected to take into account the taxes incurred by Hawaiian shareholders paid on REIT dividends for REITs without Hawaii property. Paul Brewbaker's study conducted for NAREIT (See Paul Brewbaker, "Economic Impacts of Real Estate Investment Trusts in Hawaii" (Dec. 2015), available at http://thereitwayhawaii.com) estimates, using Internal Revenue Service statistical data, that Hawaii receives approximately $8.7 million in tax on all REIT dividends. Hawaii's state protectionism if followed by other jurisdictions could end up harming the investment returns of Hawaiian shareholders and reduce tax revenues received by Hawaii.

Please do not allow the perception of a revenue increase override the long-term economic benefits that REIT investment under the existing tax regime brings to the state of Hawaii and its residents. For the foregoing reasons, we respectfully oppose House Bill No. 1012 and urge you to not let it move forward. Thank you for your consideration.

Sincerely,

Francis Cofran
Senior General Manager

Sandeep Mathrani
Chief Executive Officer

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

LATE

Matthew Friedman, PhD
Contact: 303.898.9111

Wednesday, February 8, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

This bill is an opportunity to reform an inefficient law that favors wealthy mainland interests over local businesses. Closing the dividends paid deduction (DPD) loophole and taxing Real Estate Investment Trusts (REITs) the same as other local firms is fair, equitable, and prudent. It will, without question, have a strictly positive impact on state corporate income tax (CIT) receipts while simultaneously bolstering the competitiveness of local real estate firms competing against larger mainland interests. Eliminating the DPD loophole will restore fairness to the tax system and increase revenues, allowing the state to better invest in programs and infrastructure that will benefit the entire state – not just the wealthy foreigners currently benefiting from the special tax advantage that would be temporarily eliminated were this bill to become law.

The DPD granted to REITs is one reason that Hawai'i lags behind the rest of the nation in its ability to capture corporate tax revenue related to business activity occurring within the state. According to data from the U.S. Census Bureau, Hawai'i raises a smaller portion of its total tax revenue from CIT than almost any other state, including many that have lower CIT rates. Unless loopholes like the one addressed in this bill are identified and closed the state will continue to see the tax base eroded and the ability of the government to promote economic activity imperiled.

Based on reported industry-wide returns, as well estimated values of REIT owned assets in Hawai'i offered by NAREIT, it is obvious that this bill has the potential to raise significant revenues for Hawai'i without jeopardizing our ability to access capital and attract outside investment in the state. Conservative estimates are in the range of tens of millions of dollars annually, while baseline estimates using newly released data show that the state could likely double its CIT revenue were the DPD not available to REITs operating in the islands.

The DPD is a special tax advantage that should be used to incentivize firms to engage in activity that benefits the state broadly. In this case, it simply motivates firms to alter their organizational structure so as to enjoy their corporate profits tax free. This is the definition of a giveaway and it needs to be halted. It is bad for Hawai'i businesses and it is bad for Hawai'i taxpayers.

I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

From:	Allen Stack Jr <astackjr@gmail.com>
Sent:	Wednesday, February 8, 2017 1:56 PM
To:	HSGtestimony
Subject:	SB 1012
Follow Up Flag:	Follow up
Flag Status:	Flagged

I support SB 1012.

Sincerely,
Allen Stack Jr.

Sent from my iPhone

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Anthony
Anthony_710@hotmail.com
Please note that this info will be posted on legislative website

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

LATE

Gregory L Sheehan
2145 Wells Street, #105
Wailuku, HI 96793
(808) 244-2200

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

I am a business person and in the real estate industry and very concerned about Hawaii's economy and long-term community development. *I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.*

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, road improvements, parks, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Gregory L Sheehan

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

PETER SAVIO
(808) 951-8976
1451 S. King Street, Suite 504
Honolulu, Hawaii 96814-2509

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

Imagine a developer or large investor coming to Hawaii and offering to buy hotels, shopping centers, office buildings, industrial parks and residential projects. He explains he is coming to Hawaii due to our strong market and stability. He sees the potential to make a reasonable operating profit and even more on the appreciation or increase in value over time. He only asks the State of Hawaii for one thing. All he wants is to pay No State Income Taxes as long as he owns the properties.

Of course, we would say that is not a reasonable concession and would only raise the taxes on the local residents. We would tell the buyer to take their money and buy somewhere else.

Unfortunately we are not doing that. We are allowing many mainland and local companies to avoid paying millions in state taxes due to our willingness to accept the federal tax laws as a basis for our state taxes. We need to demand our legislative plug the tax loophole that was given to the "Real Estate Investment Trust" (REIT)S by the federal government. Hawaii's adopted the federal tax code as the basis of our state tax code. Therefore, a REIT pays no federal taxes + state taxes as long as it pays out 95% of its net income yearly out to its stockholders.

The federal government doesn't care since the stockholders receiving the dividends paid to them by the REITS claim it as income on the federal tax returns and pay the federal income taxes on the REIT dividend to the federal government. The state gets nothing unless some of the stockholders live in Hawaii. Unfortunately the majority of the REITS are mainland or foreign owned. The state doesn't receive as much as it gave away. REITS earn the money in Hawaii, pay no state of Hawaii taxes, but the stockholders pay the state taxes on the mainland depending on where the stockholders live.

Hawaii as did most states, adopt the federal tax code and by doing so automatically waive the state taxes on REITS. Being a small state and since we have such a strong real estate market we have more REIT owned property than most states based on our size.

We need to ask our legislature to plug the REIT loophole and keep that state tax revenue in Hawaii. We need to reduce the tax burden to the local taxpayer. This is the lost tax revenue that can pay for schools, housing, healthcare, etc.

Our legislators need to put Hawaii residents first and stop giving the REITS a tax free status in Hawaii.

Let's keep the tax revenue in Hawaii instead of having it paid to a mainland state. Let's reduce our resident tax responsibility instead of giving our tax revenue to a mainland state. Let's follow the state of New Hampshire which has already plugged the REIT loophole and now charge them all state taxes.

The REITS will say they do all kinds of wonderful things, but they do what all local owners and tax paying owners would. The only difference is REITS pay no state income taxes. Of course, they will fight to keep that benefit. We the tax payers of Hawaii need to fight and see that the pay taxes like everyone else.

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Jason N Owens
Jason.n.owens@gmail.com

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

The Twenty-Ninth Legislature
Regular Session of 2017

HOUSE OF REPRESENTATIVES
Committee on Housing
Rep. Tom Brower, Chair
Rep. Nadine K. Nakamura, Vice Chair
State Capitol, Conference Room 423
Thursday, February 9, 2017; 9:00 a.m.

STATEMENT OF THE ILWU LOCAL 142 ON H.B. 1012
RELATING TO REAL ESTATE INVESTMENT TRUSTS

The ILWU Local 142 **supports** H.B. 1012, which temporarily disallows the deduction for dividends paid by Real Investment Trusts (REITs) for a period of 15 years, but with an exception for dividends generated from trust-owned housing that is affordable to households with incomes at or below 200% of the median family income.

The State is losing out on millions of dollars in taxes because of because of the tax deduction for dividends paid by Real Estate Investment Trusts. REITs are able to avoid paying state taxes as long as they distribute 90% of their taxable income to shareholders, who then pay taxes only in their home states. Most of the REITs with real estate holdings in Hawaii have shareholders/investors who do not live in Hawaii. Since REITs themselves currently enjoy a deduction for dividends paid, and most shareholders are not Hawaii taxpayers, the State receives virtually NO taxes from real estate activity of REITs in Hawaii.

The State can certainly use another revenue source. Requiring REITs to pay income taxes would be one means of generating revenues to support the services and programs needed to address a myriad of issues facing our residents—including public education, early childhood education, homelessness and affordable rental housing, access to quality health care, and support for the elderly and disabled as well as their caregivers.

Those who oppose repealing the deduction argue that REIT investment will dry up. We think this is most unlikely. Real estate in Hawaii is highly profitable. Investors would be foolish to pull out of Hawaii simply because of taxes they must pay. Paying taxes should be considered a cost of doing business. Everyone should pay their fair share of taxes to benefit the entire community.

S.B. 1012 calls for the law to be repealed in 15 years. Although we believe a repeal is not necessary, we can see that removing the deduction for a temporary period is one way to test the true impact of the lost deduction. Will it drive REITs from Hawaii? Or will REITs continue to do business in Hawaii and will the added revenue allow the State to do more for its residents?

The ILWU urges passage of S.B. 1012. Thank you for the opportunity to offer testimony on this measure.

From: Kayla Rosenfeld <krose@hawaiiantel.net>
Sent: Wednesday, February 8, 2017 7:06 PM
To: HSGtestimony
Subject: HB1012

Follow Up Flag: Follow up
Flag Status: Flagged

Representative Tom Brower, Chair
Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Kayla Rosenfeld
krose@hawaiiantel.net

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts

As a business person concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

There is more REIT-owned property in Hawaii per capita than any other state in the nation. And with our attractive real estate market, this will only increase in the future to further deplete our tax base. Since the DBEDT study was completed in 2015, the value of REIT property in Hawaii has already grown by 50% to $16 billion. Ala Moana Shopping Center, Pearlridge Shopping Center, Hilton Hawaiian Village, International Marketplace, plus hundreds of other properties owned by mainland companies operate here without paying any income tax. This loophole must be closed so that REITs are taxed the same way as other real estate investors.

For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify

Kayla Rosenfeld

Sent from my T-Mobile 4G LTE Device. Please excuse any typos.

Kayla Rosenfeld, Wild Rose Communications
krose@hawaiiantel.net
www.wildrosecommunications.wordpress.com
808-230-5960 tel/txt

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Committee on Housing

Tia Teves
528 Ahakea Street
Honolulu, HI 96816

Thursday, February 9, 2017

Support for H.B. No. 1012, Relating to Real Estate Investment Trusts (REITs)

As a business person and community member concerned about Hawaii's economy and long-term community development, I strongly support H.B. No. 1012, Relating to Real Estate Investment Trusts.

This bill corrects a glaring loophole in our state income tax law that allows mainland corporations operating profitably as REITs in Hawaii to take the net income out of our state without paying income tax like the rest of us. This results in a loss of $30 to $60 million annually to the state. These funds are desperately needed to support the costs of education, social services, and other state commitments, which continue to struggle.

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For these reasons, I urge the committee to pass H.B. No. 1012. Thank you for the opportunity to testify.

Sincerely,

Tia Teves

LATE

February 8, 2017

Representative Tom Brower, Chair
Representative Nadine Nakamura, Vice Chair
Members of the House Committee on Housing
Conference Rm 423
State Capitol
415 S Beretania Street
Honolulu, HI 96813

RE: Support for HB 1012 – Relating to Real Estate Investment Trusts

I write in support of HB 1012 which will help to strengthen Hawaii's economy and support community development. I urge the State Legislature to pass HB 1012 and close the loophole in our state income tax law so that REITS operating in Hawaii are taxed similarly to other real estate investors and corporations. The DEBDT study of 2015 on REITs points out that currently millions of dollars in taxes are not being captured by the state due to a loophole which allows Hawaii REIT properties to forgo paying income taxes on income from properties located and operated here.

Sincerely,

Elizabeth L. Stack
589-9927

Michael J. Fergus

125 MERCHANT STREET, SUITE 200
HONOLULU, HAWAII 96813
TELEPHONE (808) 545 1700
FAX (808) 545-1788

February 9, 2017, 9:00 AM
House Conference Room 423

LATE

TO: Committee on Housing
Rep. Tom Brower, Chair
Rep. Nadine Nakamura, Vice Chair

FROM: Michael J. Fergus

RE: **In Support of HB 1012, Relating to Real Estate Investment Trusts**

Members of the Committee on Housing:

Our tax base in Hawaii is at risk; not just the general excise tax and transient accommodations tax but also our income tax. Numerous hotels, shopping centers, office buildings and industrial parks owned by mainland REITs are basically exempt from Hawaii income tax.

The number of REIT-owned properties in Hawaii is growing very quickly. There is 50% more REIT-owned property now than there was two years ago when DBEDT completed its study. DBEDT found that there was $11 billion of REIT-owned property in Hawaii as of 2014, including Ala Moana Center, Pearlridge Center, all 11 Public Storage buildings, Bishop Square, Davies Pacific Center, Whalers Village, and hundreds more properties on all islands. Since then, Hilton Hawaiian Village, Hilton Waikoloa, International Marketplace, all of A&B's properties which include most of Kailua commercial, and many other hotels have become REITs. The total value of REIT property is now around $17 billion. The lost taxes in 2017 are estimated to be more than $50 million. By not taxing REITs in Hawaii, residents of this state are subsidizing the shareholders of those organizations.

Let's use Ala Moana Center as an example.

Who is benefiting from the REIT tax exemption?
Ala Moana Center is owned by General Growth Properties, 37% of which is owned by the Norway Investment Fund, the government of Abu Dhabi, and a Canadian investment company. So we are subsidizing foreign entities. Another significant shareholder is the President of General Growth, Sandeep Mathrani. He received a salary of $39 million in 2015. By not making Ala Moana Center pay income taxes like everyone else, we are subsidizing his salary.

Don't REITs have to pay other taxes?
General Growth will tell you that they pay general excise tax and property tax. Not really. Ala Moana Center makes its tenants reimburse 100% of those taxes so it effectively pays no taxes.

In addition, General Growth protests any increases in its real property tax assessments so aggressively that Ala Moana Center's total assessment for 2016 was only $1.2 billion for the entire property when it had just sold 37.5% for $2.2 billion. The City is losing $50 million a year in real property tax due to General Growth's aggressive assessment appeals.

What about capital gains tax?
In 2015, when General Growth sold 37.5% of Ala Moana Center for $2.2 billion, it resulted in a gain of $960 million. But they were exempt from the $38 million in capital gains tax that any other property owner would have had to pay. If this bill had been passed two years ago, the State of Hawaii would have received $38 million in capital gains tax from General Growth, plus the $36 million that DBEDT estimated to be the income tax on all REITs at that time, for a total of $74 million for one year.

Ala Moana Center constitutes a large percentage of REIT property in Hawaii and very little of its income stays in this state. Neither does it contribute significantly to our community's charities.

Every company earning income in Hawaii should be paying its fair share of taxes, especially out-of-state companies that offer low-wage jobs to our community members. I have given you good reasons to vote for this bill. Our tax base will just keep shrinking unless you act now.