UNIVERSITY OF HAWAI‘I SYSTEM
Legislative Testimony

Testimony Presented Before the
House Committee on Finance
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by
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HB 1735 – RELATING TO PROPERTY TAXES

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

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

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

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

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

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

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

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

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

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

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