

COUNCIL ON REVENUES

Meeting Minutes, Thursday, August 1, 2019 (2pm)

**DLIR Conference Rooms
Princess Ruth Keelikolani Building
830 Punchbowl Street, Third Floor
Rooms 310-313
Honolulu, Hawaii**

PRESENT:

Council Members:

Kurt Kawafuchi, (Chair), Marilyn M. Niwao (Vice-Chair), Carl S. Bonham, Jack P. Suyderhoud, Jessica E. Gluck, Kristi Maynard and Scott W. Hayashi

Staff Members:

Department of Taxation (the Department): Seth Colby, Baybars Karacaovali and Jacquelyn Guitguiten

Department of Budget and Finance (B&F): Terri Ohta, Ken Shirokane and Gregg Hirohata-Goto

Others:

Sharon Kotaka, Budget & Finance
Wesley Machida, Senate Ways & Means
Janoh Palko, Senate Ways & Means
Rona Suzuki, Director of Taxation
Damien Elefante, Deputy Director of Taxation

CALL TO ORDER:

The Chair called the meeting to order at 2:00 p.m. A quorum was present.

ELECTION OF CHAIR AND VICE-CHAIR

Chair Kawafuchi said he's been Chair for 3 terms and that he's opened to suggestions. He said he's willing to 'pass the torch' and also he will be happy to continue to serve. Ms. Niwao nominated Chair Kawafuchi. Dr. Suyderhoud seconded. Chair Kawafuchi asked if there were any further discussion. There was none. The vote was unanimous.

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Carl S. Bonham	Yes
Jack P. Suyderhoud	Yes
Jessica E. Gluck	Yes
Kristi L. Maynard	Yes
Scott W. Hayashi	Yes

Chair Kawafuchi asked for the vote for the Vice-Chair. Chair Kawafuchi said he nominates Ms. Niwao to continue another term as Vice-Chair. Ms. Maynard seconded. Chair Kawafuchi asked if there were any further discussion. There was none. The vote was unanimous.

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Carl S. Bonham	Yes
Jack P. Suyderhoud	Yes
Jessica E. Gluck	Yes
Kristi L. Maynard	Yes
Scott W. Hayashi	Yes

COMMUNICATIONS TO THE COUNCIL AND PUBLIC COMMENT:

Chair Kawafuchi asked if there was any communication to the Council on Revenues (the Council). There was none.

APPROVED MINUTES OF THE MEETING OF MAY 23, 2019:

Chair Kawafuchi called for a motion to approve the minutes. Ms. Maynard moved to approve the minutes. Ms. Niwao seconded.

It was moved by Ms. Maynard and seconded by Ms. Niwao that the minutes of the May 23rd meeting be accepted. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Carl S. Bonham	Yes
Jack P. Suyderhoud	Yes
Jessica E. Gluck	Yes
Kristi L. Maynard	Yes
Scott W. Hayashi	Abstain

Chair Kawafuchi introduced and congratulated the newest Council on Revenues Member, Mr. Scott Hayashi appointed by House Speaker Scott Saiki.

Mr. Hayashi said he was born and raised in Honolulu, Hawaii. He left Hawaii to attend school on the mainland in 1989. And, after law school he worked for Deloitte & Touche, LLP in San Francisco for 10 years and then 12 at Apple Inc. in San Francisco. He said he moved back home and worked for Alexander & Baldwin, Inc. for 5 years. Mr. Hayashi said he is a Tax Attorney with CW Associates, CPAs since 2017. Chair Kawafuchi thanked Mr. Hayashi.

TOTAL PERSONAL INCOME FORECAST FOR CY 2019:

Next, the Council discussed the total personal income forecast for CY 2019. Dr. Colby said in terms of the models for TPI (Total Personal Income), one of the biggest drivers of the TPI are visitor arrivals which depend on historical data and the COR Members' estimates and forecasts. That does not include the impact of Bill 89. Dr. Colby said Bill 89 went into effect today (August 1st), and it applies only to the County of Honolulu. It effectively bans all short-term rentals of all entire units (houses or condos) outside of resort zones (which is not all of Waikiki). He said it does provide a provision for owner occupied units. However this provision will not go into effect until October 2020. Dr. Colby said in October 2020 you can apply to rent out maximum of two rooms in a unit. The owner has to be present and own the house and pay certain fees to get that application. It is only allowed 0.5% of all housing stock and cannot be within 1,000 feet of another renter. He said it's quite restrictive.

The Council Members continued the discussion on Bill 89 (which only applies to Oahu). They discussed how Bill 89 enhances enforcement capabilities of the country. The central question is how this law will be enforced by the City and County of Honolulu.

Also mentioned was Oahu TAT revenues represented about 45% of the State TAT revenues and Bill 89 qualifying zoning provisions. Dr. Bonham said the July count for TVU's is around 9,600. He said it doesn't matter if its 7,000 or 7,500 or 6,500, the impacts are potentially large. You can imagine if 7,000 of those units (the vast majority of the units) being rented are whole homes-- something like 80 or 85% of the units being advertised are whole homes. There are likely scenarios where you can lose 5%, 10%, or 15% of your visitors and their spending. We're potentially talking about a large hit to spending. Some of them will go to the other islands, some will come to Oahu and stay a shorter amount of time in a hotel and then go to another island.

Dr. Suyderhoud asked if the airlines are also looking at this. If you don't find a place to stay then you don't fly—are people cancelling reservations? Dr. Bonham said it was a good question. He said it hasn't shown up in the seat count yet so we have an estimate for the number of airline seats being flown to the state by island. We do have for U.S. for domestic by island. The state numbers are all up at 4, 5%.

Chair Kawafuchi asked Dr. Bonham if he's saying 10 to 15% of the capacity to accommodate tourists on Oahu is being reduced.

Dr. Bonham said the issue is enforcement. Chair Kawafuchi said what is the sense of the compliance, who is actually paying taxes? Dr. Bonham said we don't know—this isn't about TAT. Dr. Bonham said what Bill 89 does is it makes it so that the City can impose fines on you for actually advertising a unit. So, it's essentially trying to cut out the advertising channel. Dr. Colby said the City will send a warning. If the advertisement remains posted after 7 days, the fine varies from \$1,000/day up to \$10,000. Dr. Bonham said if you were renting a unit, and it was illegal, and you've faced the prospect of that kind of a fine. I would stop advertising. And so the question is how the City is going to start the enforcement. So, last Friday they sent in the press 5,000 letters to potential violators, and they've had a lot of concerns with homeowners

calling them. The problem is how do you identify the property because it's a challenge, it's very difficult.

He said at a minimum they would be able to presumably start sending out fines to properties they can identify because they've had a complaint from a neighbor. Chair Kawafuchi asked whether the state moved to try to get the list of people but the court action was denied. Ms. Maynard said yes. Dr. Colby said but that was for state auditors so that's different to see if people pay taxes. That has nothing to do whether they are legitimate or legal or illegal. Chair Kawafuchi said he's not saying if they are legal or illegal. Ms. Maynard said she heard is that Airbnb has a pin drop that gives an approximate location so these letters were sent out to the approximate location and that's why you have 1,000 complaints on the 5,000 letters because a lot of people who do not rent out were getting letters.

Chair Kawafuchi said Hawaii doesn't have a John Doe Summons Law, and that's how the IRS would get the information. Dr. Bonham said it either requires staff that is willing to do some footwork and or software. The other thing is that you can imagine in places like Kailua and on the North Shore, they will rely on complaints from neighbors. If the City starts publicizing the fines of up to \$10,000.00, it will have an impact.

Dr. Bonham said that tourists who already booked places are going to start worrying is it going to be there when they get there. So, you have to expect there's going to be negative repercussions. In UHERO's models, one of the things that happen first is the length of stay goes way down and occupancy and room rates go up. It affects the whole economy.

Ms. Niwao said on Maui we had similar crack-downs on illegal vacation rentals, and the penalty was continuing every day with \$1,000.00. Ms. Niwao said she had clients that bought property to rent out short term that was illegal, and they were burned because they received a notice. Once you received a notice, inspectors went out and they made sure the property wasn't being rented as vacation rentals; however these houses that they built were built specifically for vacation rentals. Some of these homes had no other purpose other than to be used as vacation rentals. Ms. Niwao asked whether it is just the advertising they are going to penalize or are there inspectors also going to go out to the units? Dr. Colby said they are not allowing applications until October 2020, and the City has not developed the manpower to really go after violators. The City will develop enforcement capabilities over the next year. Right now they have the legislative and legal authority will probably be challenged in courts as well. He said the moral of the story is there're millions of unknowns and the unknowns we're talking about represent billions of dollars. If they could enforce everything down to zero, the impact would be huge.

Chair Kawafuchi asked Ms. Gluck if the Outrigger has a sense of vacation rental as to how big it was. Ms. Gluck said no. Dr. Bonham said the growth in visitors since 2013 has all been vacation rentals. Dr. Bonham said there's another effect that we haven't mentioned at all. There's a lot of people who have purchased houses on the North Shore, in Kailua and somewhere specifically for the purpose of rental. He said that income stream is very much a threat and if they've bought these homes anytime in the last 5 years (other than 2009 or 2010). They can't cover their mortgage on any of the possible income stream, so you can't cover it on long-term

rental. There's a potential for 5 or 6 or 7,000 homes to go into the for sale market. Some will go into long-term rental market but some of them will definitely go on the for-sale market and that's three years' worth of construction potentially dumped on the market. We don't know how the enforcement is going to work, but there's definitely going to be some psychological effects on both potential home buyers and on people that are holding these properties and trying to figure out what to do.

Dr. Suyderhoud said out of curiosity, if the home is owned by somebody is an out-of-state owner, and their income goes down, is that a Hawaii decline and a Hawaii personal income or is it a decline in residents.

Dr. Bonham said whether or not the BEA captures that in their measure of State income. So I live in Texas and I own 5 houses on Maui that I rent and my rental income goes down, so taxable income in Hawaii is going down but the question is does total personal income in the State of Taxes go down because I earned it and I'm a resident in Texas. He said he suspects that's how it works. He said that's the concept they're measuring is the income of the people of the State of Texas.

Dr. Suyderhoud said that's what we're looking at total personal income of the people of Hawaii. Dr. Bonham said yes. He said there's quite a bit of capacity on the Big Island although they lost a lot of vacation rentals with of Kilauea volcano eruption. And, they're bouncing back fast. I saw their hotel occupancy data was up to the high 70s, so there's a limit to how many of these people could be accommodated. Chair Kawafuchi said the Council looks forward to Dr. Colby providing an update for the next general fund meeting.

Mr. Hayashi said one of his friends is a hotel exec and he mentioned that when the influx of the new discount carriers were coming in (not just Southwest), but Air Asia and some of the others. He said the concern was that Air Asia especially caters to a very different clientele that would not spend a lot of money. He was embracing Southwest coming in because the airline caters to the business travelers, so his thinking was they were going to use the miles, come to Hawaii and spend their money. But the interesting question there is they also have points on the hotels too so he wasn't sure if the hotel spending is up but you would think the other spending on food, etc. He said that's what his view was, but he was embracing it. He had to catch up with him to see whether that's playing-out because this is his view before Southwest started coming here.

Dr. Bonham moved 2.7%. Ms. Niwao seconded. Chair Kawafuchi asked if there was any discussion. There was no further discussion. The vote was unanimous.

It was moved by Dr. Bonham and seconded by Ms. Niwao that the Total Personal Income forecast be 2.7% for CY 2019. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Carl S. Bonham	Yes

Jack P. Suyderhoud	Yes
Jessica E. Gluck	Yes
Kristi L. Maynard	Yes
Scott W. Hayashi	Yes

TOTAL PERSONAL INCOME FORECAST FOR CY 2020:

Dr. Bonham said last year the current data for jobs says about a half percentage point of growth. And, we saw nominal growth last year at 2.9 and inflation in 2018 was 1.9. Chair Kawafuchi asked if he thought inflation is still going to stay about 2%. Dr. Bonham said yes.

Ms. Maynard made a motion to lower it to 2% given all the uncertainty of the vacation rentals. Ms. Niwao seconded. Chair Kawafuchi asked if there was any further discussion.

Mr. Hayashi said there was an article in this morning's newspaper the fact that if Trump doesn't get re-elected they said it could throw the markets and everything else into complete turmoil.

Dr. Bonham said the political uncertainty is very real but in terms of the election that's not uncertainty, that's unknown. Ms. Niwao said she heard more of a doom and gloom for next year as far as the markets go and as far as the economy goes. Some of the investment bankers were saying that next year is going to be a very bad year for the markets. She said we've been doing well for so long. Dr. Suyderhoud said they've been saying that for 3 years. Ms. Gluck said one year, you're going to be right. Dr. Suyderhoud said I'm sure the answer to that is yes. Dr. Bonham said so we have a motion. So one thing we haven't talked about is what this forecast is for. And, for the new members that might be useful.

Dr. Colby said there's a law that limits general fund spending a percentage TPI (multiple years). He said the actual operational outcome of these decisions hasn't been relevant. Dr. Bonham said they haven't been binding. Our goal still is to move it out of the general fund—the numbers get used in other places. Ms. Gluck asked if we have a sense of how low it would have to drop to become an issue.

Dr. Bonham said it may have been in 1996, 1997 when (former) Governor Benjamin Cayetano cut income taxes and tax revenues fell and it has happened but it's been a long time. Chair Kawafuchi asked if there was any further discussion. There was none.

Ms. Niwao asked Dr. Suyderhoud if it's in his opinion that 2.5% was too high. Dr. Suyderhoud said it's too high if we fall off the cliff because of Bill 89, but it's not too high if we don't fall off the cliff.

Dr. Colby said he is modeling at least two different scenarios: 1) there's complete enforcement and 2) half enforcement whereas you cut the number of vacation rentals by half.

Ms. Maynard said but you have to come up with estimates. Dr. Colby said yes, he's looking at them.

Dr. Suyderhoud called to question. Chair Kawafuchi said the next meeting is in November. Ms. Maynard said and at that time we can take another look at it and we might have better information. Chair Kawafuchi asked for the vote. The vote was unanimous.

Ms. Maynard made a motion to lower the Total Personal Income forecast at 2.0% for CY 2020. Ms. Niwao seconded. The Chair called for the vote, and the motion passed with the following votes:

Kurt Kawafuchi	Yes
Marilyn Niwao	Yes
Carl S. Bonham	Yes
Jack P. Suyderhoud	Yes
Jessica E. Gluck	Yes
Kristi L. Maynard	Yes
Scott W. Hayashi	Yes

NEXT MEETING:

The Council tentatively agreed to meet on Thursday, August 29, 2019 at 2 p.m. However, the date and time will be re-confirmed by email. The Council staff will attempt to secure the DLIR Conference Rooms 310-313.

ADJOURNMENT:

The meeting adjourned at 3:01 p.m.