Real Estate Investment Trusts in Hawaii: Analysis and Survey Results

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Department of Business, Economic Development & Tourism
Research and Economic Analysis Division

Table of Contents

EXECUTIVE SUMMARY

Act 239, SLH 2015 (SB0118 SD1 HD2 CD1) required the state Department of Business, Economic Development and Tourism (DBEDT), with the assistance of the state Department of Taxation (DOTAX), to study the impact of real estate investment trusts (REITs) in Hawaii. The Hawaii State Legislature appropriated $100,000 for the study. Due to budget restrictions, $90,000 was approved and released by Governor David Ige. A contract was awarded to SMS Research in mid-December 2015 and the study started in January 2016.

The study included four surveys in order to collect data to address the 13 categories of analysis required by Act 239. Responses addressing the data requirements identified in Act 239 are in Appendix C of the report. The four surveys were: (1) Survey of Hawaii Resident Taxpayers; (2) Survey of Hawaii Investment and Financial Companies; (3) Survey of Real Estate Related Companies Located in Hawaii; (4) Survey of Industry Experts and Other Stakeholders.

An interim report was submitted to the legislature in December 2015. The interim report included the literature review of REITs, the estimated number of REITs operating in Hawaii, their total asset value, estimated amount of dividend income exempted from the state corporate income tax, and the estimated amount of state taxes foregone. This final report includes updates of the estimated numbers and the results from the surveys.

A summary of the results are as follows:

- 42 REITs were identified operating in Hawaii (37 via US Securities and Exchange Commission filings, 3 more via Costar, a commercial real estate database, and 2 via surveys).
- Only one REIT had its main office in Hawaii in 2014
- Total assets for the REITs identified in 2014 in Hawaii were estimated at $7.8 billion at cost basis (10-k filings). However, this amount may be incomplete and does not reflect the current market value of the properties.
- 50.8% of the assets were in the retail industry and 24.7% were in hospitality related industries.
- Hawaii dividend income exempted from corporate income tax was estimated to be $720.6 million in 2014.

- Estimated net income for REITs with property in Hawaii increased 2.6 times between 2012 and 2013, from $79.9 million in 2012 to $208.8 million in 2013, and by over 3 times between 2013 and 2014, from $208.8 million to $720.6 million.
- Estimated corporate income tax revenues foregone by the State of Hawaii, due to the REIT dividend paid deduction (DPD), were approximately between $0.3 million for 2009 and $36 million for 2014 ($35 million accounting for offsets from state taxes paid by Hawaii residents for REIT dividend income).
- The average amount in corporate income taxes foregone by state between 2009 and 2014 was estimated at approximately $9.6 million per year.
- The retail sales from REIT properties in Hawaii (50.8% of the total REITs) generated about $207 million in State General Excise Tax (GET) in 2014.
- The survey results showed that between 1.8% (direct investment) and 12.8% (indirect investment) of Hawaii households receive income from REIT dividends, which is between 8,114 and 57,698 households.
- Additionally, between 0.5% and 3.0% of Hawaii taxpayers invest in REITs *with property in Hawaii.* This results in a total of between 2,254 and 13,523 household investors in REITs with property in Hawaii.
- The resident taxpayer survey showed that the average REIT investment for Hawaii-based REIT investors was $12,861 for households with incomes below $100,000 and $42,048 for households with incomes of $100,000 and above.
- The "Married Filing Separately" category had by far the highest average investment in REIT, at $81,748, while the "Single" category had the lowest average investment at $10,124.
- REITs indicated that, if the DPD were repealed, real estate investment in Hawaii would decrease by between 11% and 30 % within five years. In contrast, a majority of non-REIT real estate companies indicated there would be no change in real estate investment within five years of repealing the DPD.

ACKNOWLEDGEMENTS

DBEDT would like to thank DOTAX for their assistance with providing aggregate tax data for real estate investment trusts. In addition to providing aggregate tax data, DOTAX also reviewed this report and provided helpful comments and suggestions throughout the process.

DBEDT would like to thank SMS Research for their work conducting the surveys and Pedro Villarreal and Dr. David Hunter of the University of Hawaii for their assistance with REIT financial data.

I. INTRODUCTION

In recent years, many states have re-examined the corporate income tax deductions associated with Real Estate Investment Trusts (REITs), especially captive REITs. During Hawaii State Legislature's 2015 session, a bill was introduced (SB-118), which proposed that the Department of Business, Economic Development and Tourism (DBEDT) conduct a study regarding REITs. The bill passed and became Act 239 (SLH 2015). The new law mandated that DBEDT, with the assistance of the Department of Taxation (DOTAX), study the impact of real estate investment trusts in Hawaii, and the possible effect of repealing the dividends paid deduction for real estate investment trusts.

This report answers the research questions regarding REITs, put forth by the legislature and mandated by Act 239 (SLH 2015) – see Appendix C for detailed requirements of Act 239. The report includes the results of four surveys, covering: Hawaii resident taxpayers, investment and financial companies, real estate companies, and industry experts and stakeholders.

II. OVERVIEW OF REITS

REITs were established in 1960 by the U.S. Congress to allow individual investors to invest in large-scale, income producing real estate, without having to buy the real estate directly. Generally, REITs own income producing real estate or real estate-related assets. REITs are taxed under sections 857 and 858 of the Internal Revenue Code (IRC), which Hawaii has adopted for state tax purposes.

There are three types of REITs. First, ***Equity REITs*** own and operate income-producing real estate. Second, ***Mortgage REITs*** derive income from real estate loans either directly by owning mortgages or other types of real estate loans, or indirectly through mortgage-backed securities. Third, ***Hybrid REITs*** are a combination of Equity REITs and Mortgage REITs.

By law, a REIT must distribute at least 90% of its taxable income in the form of shareholder dividends. The amount distributed to shareholders as dividends then becomes tax deductible for corporate income tax and this is called a Dividend Paid Deduction.

In addition to the mandatory dividend distribution of taxable income, other REIT requirements include: [1]

- Be an entity that would be taxable as a corporation but for its REIT status.
- Be managed by a board of directors.
- Have shares that are fully transferable.
- Have a minimum of 100 shareholders after its first year as a REIT.
- Have no more than 50% of its shares held by five or fewer individuals during the last half of the taxable year.
- Invest in 75% of its total assets in real estate and cash.
- Derive at least 75% of its gross income from real estate-related sources including rents from real property and interest on mortgages financing real property.
- Derive at least 95% of its gross income from such real estate sources as dividends or interest from any source.
- Have no more that 25% of its assets consist of non-qualifying securities or stock in taxable REIT subsidiaries.

Once a REIT pays out a minimum of 90% of its taxable income as dividends, shareholders pay income taxes on those dividends. However, income paid out as dividends by a REIT, generally, is not subject to state corporate income tax and this has implications for state tax revenue.

Item 7 of Act 239 required an examination of "captive REITs." Captive REITs arose as an unintended consequence of the REIT law as entities spun off their real estate holdings into a related-subsidiary. Simply stated, a captive REIT is a REIT created for the sole purpose of receiving rent from a related entity in order to take advantage of the dividend paid deduction. The Multistate Tax Commission defines a captive REIT as:

> A real estate investment trust the shares or beneficial interests of which are not regularly traded on an established securities market and more than 50% of the voting power or value of the beneficial interests or shares of which are owned or controlled, directly or indirectly, or constructively, by a single entity that is:
> 1. treated as an association taxable as a corporation under the Internal Revenue Code of 1986, as amended, and
> 2. not exempt from federal income tax pursuant to the provisions of Section 501(a) of the Internal Revenue Code of 1986, as amended. In order to

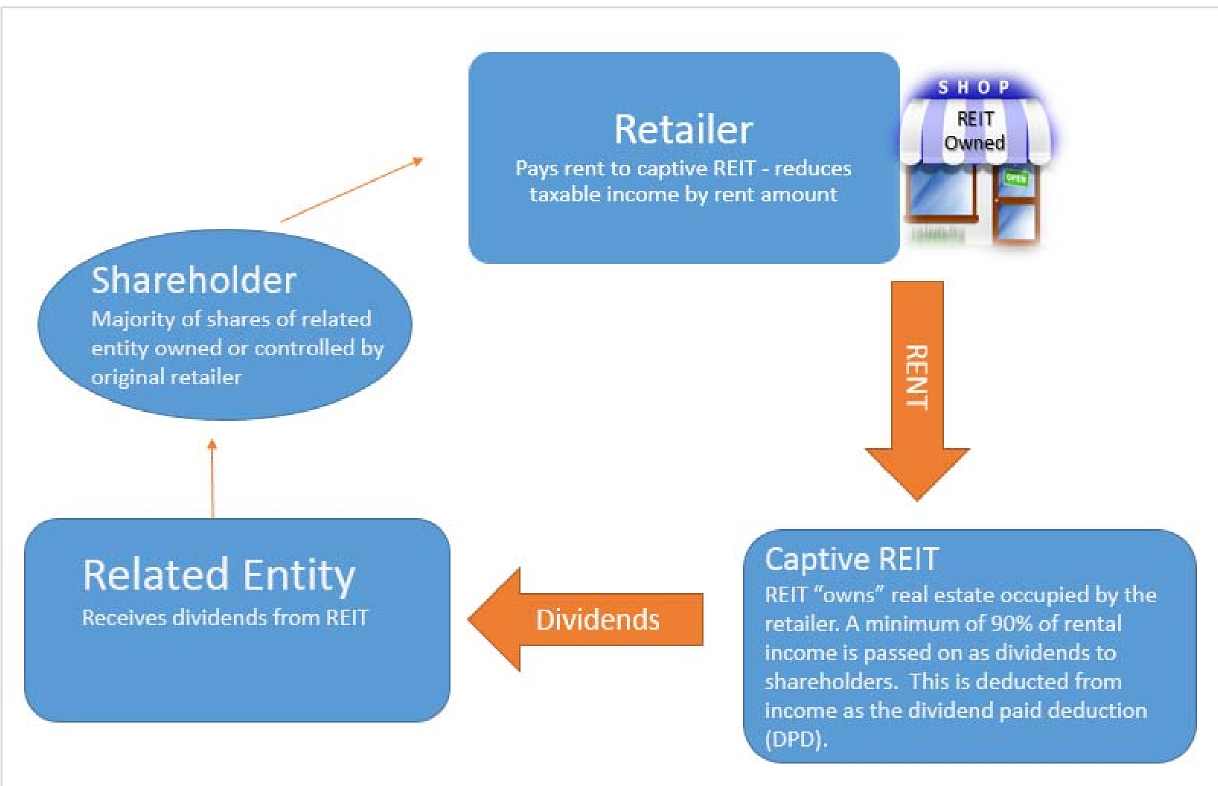
[1] Security and Exchange Office of Investor Education and Advocacy, 2011, Real Estate Investment Trusts (REITs) Investor Bulletin.

meet the 100 shareholder requirement, shares are often held by company employees or board members.[2]

While the above definition is rather technical, two key concepts emerged that many states would adopt to separate captive REITs from other REITs: 1) captive REITs are not traded on an established securities market, and, 2) captive REITs are more than 50% owned or controlled by a single entity. As will be seen in the next section, many states relied on these two characteristics to close captive REIT state tax loopholes.

There are two types of captive REITs; rental REITs and mortgage REITs (Garrett, 2007). The rental captive REIT is most often used by large multi-state retailers, which spin off their real estate holdings into a separate REIT entity (Figure 1). The retailers are then able to reduce their taxable income by the amount of the rent paid to the REIT through the dividend paid deduction (DPD). The REIT then distributes at least 90% of this income to shareholders, a majority of which may be controlled by the original retail entity.

Figure 1. Retail Captive REIT Structure



[2] Multistate Tax Commission, 2008

The above example is for a dividend paid by a REIT to shareholders. In some states, it may be possible to gain a second deduction for the dividends received from a REIT by setting up an entity to receive the REIT dividend. The deduction for dividend received is called a dividend received deduction (DRD). While U.S. Revenue Code allows for a 70% deduction of dividends received by corporations, *it does not allow this deduction when received from REITs*. U.S. revenue code specifically states, "Any dividend received from a real estate investment trust … shall not be treated as a dividend".[3] However, some states did not have the above or similar clause for their tax codes, and this created an opportunity for a DRD at the state level by establishing a holding company to receive the dividends paid out by the original REIT. This created a double deduction, where the dividend paid out by the REIT is deducted on one end and the dividend received by a holding company is deducted on the other end. As will be discussed below, if the dividend received deduction is taken by a holding company out of state, the issue of state tax jurisdiction comes into play.

The second type of captive REIT is the mortgage captive REIT, which is used most often by banks (Garret, 2007). The strategy is to move mortgage interest accrued from the bank itself to a REIT entity and take advantage of the DPD, thus avoiding state corporate income tax.

As noted above, the two characteristics that emerged from the Multistate Tax Commission proposal to define captive REITs were: 1) not traded on an established securities market, and 2) more than 50% owned or controlled by a single entity. In addition to these two points, a third point specific to Hawaii is that REIT rent revenues are subject to Hawaii's General Excise Tax and this reduces the incentive to establish a captive REIT in Hawaii. Furthermore, Department of Taxation Director Maria E. Zielinski proposed a measure to limit a captive REIT's ability to benefit from the dividend paid deduction by stipulating "….dividends paid shall not apply to a captive real estate investment trust" (DOTAX Testimony, 2015).[4] The proposed measure used a definition similar to the captive REIT definition of the Multistate Tax Commission definition.

According to a survey conducted of real estate companies, there were no major captive REITs identified in Hawaii for the calendar year of 2014. Prior to 2014, Howard Hughes operated a captive REIT in Hawaii, called Victoria Ward Limited, listed in its 2013 10-K filing with the

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[3] 26 U.S. Code § 243 – d:2, Dividends received by corporations
[4] Maria E. Zielinski, Director Department of Taxation. February 18, 2015. Testimony to the Honorable Jill N. Tokuda Chair and Members of the Senate Committee on Ways and Means.

Securities and Exchange Commission. Victoria Ward Limited was re-organized in 2014 and is no longer a captive REIT. While outside the time period of this research, two REITs were identified that had formed after 2014. The first of these was Seritage, owned by Sears, and the second was Darden’s REIT unit (owner of national franchises, such as Olive Garden and other restaurants). Seritage does not fall under the MTC definition of “captive” since it is a publicly traded company, and there was not enough information available to confirm Darden’s REIT unit status.

The next section will examine various state policies regarding REITs.

III. EXAMPLES OF STATE REIT TAX POLICIES

At the state level, a majority of states conform to the federal tax code allowing the DPD for REITs[5] and disallowing DRDs for REITs.[6] The challenge for many states has been to differentiate between REITs that fulfill the original spirit of the 1960 law, establishing REITs to help small investors, and, "paper REITs," set up for the sole purpose of avoiding taxes.

Generally, there have been three approaches states have used regarding REIT tax dividends. The first is the disallowance of DPDs for captive REITs, while allowing the DPD for non-captive REITs. The second is combined reporting, mandating that captive REIT income be reported together with the parent entity. The third and most extreme is the disallowance of the DPD for all REITs, both captive and non-captive.

A state that disallows DPDs for captive REITs is Connecticut, which enacted legislation similar to the Multistate Tax Commission proposal. Connecticut defines a captive REIT as, "…a REIT where more than 50% is owned or controlled, directly or constructively, by a single entity and where the REIT is not regularly traded on an established securities market." (State of Connecticut. 2010). However, Connecticut allows exceptions to the provision when a REIT is a "qualified REIT or a REIT is more than 50% owned by a corporation that is, in turn, 10% or more constructively owned by:

- A REIT
- An entity exempt from tax under IRC §501(nonprofit entity)
- A listed property trust or other foreign REIT from a country with a tax treaty with the US; or,
- A REIT intended to be regularly traded on an established securities market."

A good example of a state that requires combined reporting is New York (State of New York, 2014). One of the foundations of the New York tax reform is requiring companies to file based on "economic nexus." In other words, as long as there is an "economic" connection to the state, physical presence is not required for taxing jurisdiction (Dibello et al., 2010).

[5] 26 U.S. Code § 857(b)(2)
[6] 26 U.S. Code § 243 (d)(3)

As of January 1, 2015, combined reporting is required for corporations and their related entities that meet the following requirements (Grant Thornton LLP, 2014):

- Owns or controls directly or indirectly more than 50% of the capital stock of one or more other corporations *or*
- More than 50% of the capital stock of which is owned by or controlled directly or indirectly by one or more other corporations *or*
- More than 50% of the capital stock of which, and the capital stock of one or more other corporations, is owned or controlled, directly or indirectly, the same interests ***and***
- Is engaged in a unitary business with those corporations.

The New York tax reform includes a provision that specifically targets captive REITs by requiring that combined returns include income generated from a "captive REIT" with the parent entity.

New Hampshire imposes an entity-level tax on REITs and does not allow for a REIT DPD, not even for publicly traded REITs.

In addition to legislation, state courts have also addressed captive REITs. One of the primary issues is a state's jurisdiction to tax dividends received by a holding company from a REIT, especially when the holding company is a different state.

One issue with entities that have locations in multiple states is the issue of transfer pricing or shifting income from one state to another as a tax strategy. Louisiana challenged the REIT dividend received deduction claimed by a holding company with an office in Nevada that originated from an Autozone-related entity located within Louisiana (Supreme Court of Louisiana, 2005). Louisiana's standpoint was that the multi-state business structure effectively transferred income from Louisiana to Nevada, which at the time did not have a state corporate income tax. The Louisiana Court upheld Louisiana's jurisdiction to tax a nonresident shareholder with the decision that, "Louisiana has personal jurisdiction over a nonresident shareholder when Louisiana has provided benefits, opportunities, and protections which helped to create the income."

On the other hand, the Kentucky courts upheld the right for a retail related REIT to claim a deduction for REIT dividends paid citing that, "AutoZone (referring to the REIT Autozone Development Corporation) properly claimed a deduction for dividends paid to shareholders on its 1995, 1996, and 1997 Kentucky corporate income tax returns was not arbitrary (Common Wealth vs Autozone, 2006-CA-002175).

Hawaii courts have also addressed captive REIT related tax issues. There were three cases identified that challenged the disallowance of dividend deductions received from a REIT subsidiary (Department of Taxation Annual Reports 2004-05, 2008-09, 2010-11). Federal tax code states that a dividend received from a REIT shall not be treated as a dividend, thus is not deductible.[7] All three cases challenged the disallowance of dividends received from a wholly owned REIT subsidiary on the basis that §243 IRC is inoperable in Hawaii. While the court originally upheld the right to tax dividends received from a wholly owned REIT subsidiary, all cases were appealed and settled out of court.[8]

[7] 26 U.S. Code §243 Dividends received by corporations

[8] Tax Appeal of HEI Diversified and Subsidiaries, T.A. No. 03-0169; Tax Appeal of Territorial Mutual Holding Company and Subsidiaries, T.A. Nos. 06-0096 and 07-0079; Tax Appeal of Central Pacific Bank, T.A. Nos. 02-0075, 03-0155, 05-0041, and 07-0098.

IV. HAWAII REIT ANALYSIS

Number of REITs operating in Hawaii. To identify the number of REITs with properties in Hawaii, DBEDT used a two-step process:

1. Identify REITs operating in Hawaii. This was done by researching the US Securities and Exchange Commission's EDGAR database, the CoStar database (DBEDT), which is a commercial real estate database, and by administering a survey to all real estate companies in Hawaii. Additionally, DOTAX researched an IRS 2014 business database to identify any other potential REITs. A total of 69 potential REITs were identified by the two departments. The ones identified by DBEDT are listed in Appendix B while the ones identified by DOTAX cannot be listed due to the confidential nature of the tax data.
2. For the REITs identified in step one, the data was tabulated from Hawaii Tax Form N-30 (Hawaii Corporate Income Tax) for Tax Years 2009 to 2014 (performed by DOTAX). The methodology may exclude some companies that were REITs before 2014 and it may include some companies that did not operate as REITs in all of the years considered. Based on the assembled list of REITs, DOTAX was able to provide aggregated corporate REIT data relevant to Hawaii.

SEC's EDGAR database is comprised of filings by U.S. companies. The federal securities law requires public companies to file financial information on a quarterly and annual basis. Domestic corporations must submit annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K for a number of specified events and must comply with a variety of other disclosure requirements.[9] DBEDT primarily used corporate 10-K filings for REITs, which provide a comprehensive overview of the company's business and financial conditions and include audited financial statements. Corporations are required to file if they list their securities on an exchange or if the number of shareholders is above a certain threshold.[10] However, one downside of the EDGAR database is that it does not include smaller private REITs, which are not required to file 10-K forms with the SEC.

[9] US Securities and Exchange Commission
[10] US Securities and Exchange Commission

Generally, private REITs that fall below the following threshold are not required to file:

- 300 shareholders of the class of securities offered; or
- 500 shareholders of the class of securities offered and less than $10 million in total assets for each of its last three fiscal years.

The private CoStar database covers commercial properties in Hawaii and reports if the property is owned by a REIT. The database includes data from a variety of public and private sources, as well as their own staff who track individual properties. This database was used to identify ownership of various properties by REIT status. The Costar database is limited in that it does not provide information such as REIT revenue or the net income for a specific property. However, it complements the EDGAR database by providing information on private REITs, some of which may not be required to file with the SEC.

The data gap for REIT revenue and net income was filled with an aggregated REIT total gross revenue and net income figures from the Hawaii State Department of Taxation. The net income amount represents REIT net income attributed to the state as reported on the state's N-30 tax form and/or the federal 1120-REIT tax form. At the federal level, all REITs are required to file an 1120-REIT tax form. The SEC's database has its own limitations because some REITs do not identify their complete real estate holdings in each location or state (although most do). Therefore, there are differences in the REIT number in Hawaii based on SEC filings when compared with the estimated data provided by DOTAX.

Table 1 lists the number of REITs operating in Hawaii. The combined total investment value (which is total asset value) was estimated using the values listed in the REIT 10-K filings as reported in the EDGAR database. It is important to note, that the reported property values from the 10-K forms reflect the cost of purchase plus improvements. These property values likely do not reflect current market values and may differ from "market value" estimates. However, a significant reason for basing calculations on this number was the fact that companies use this number (their own corresponding components, which make this aggregate number) when calculating their properties' depreciation values, since market value fluctuates and may not be reliable.

Table 1. Estimated Number of REITs and Value of Their Assets in Hawaii, 2011 – 2014

Year	Number of REITs	Value of Total REIT Assets in Hawaii
2009	28 (DOTAX Estimate)	-
2010	31 (DOTAX Estimate)	-
2011	29 (DOTAX Estimate) 20 (US SEC)	$6,442,423,319[1]
2012	34 (DOTAX Estimate) 24 (US SEC)	$7,121,081,773[1]
2013	33 (DOTAX Estimate) 28 (US SEC)	$7,327,323,231[1]
2014	33 (DOTAX Estimate) 37 (US SEC) *42 (US SEC, CoStar, DBEDT REIT Survey)*[3]	$7,754,495,737[1, 2]

1. DBEDT estimate based on SEC filing, cost based asset value.
2. According to NAREIT (National Association of REITs), December 2015 market value of Hawaii REIT-owned properties added up to $11.3 billion. There are important limitations to this number, as follows: A. market value changes constantly, so December 2015 figure is no longer relevant; B. only 20 of the 42 REITs identified in Hawaii are members of NAREIT – therefore many properties are not accounted for. Therefore, it is possible that the real current market value of all REIT properties in Hawaii is higher than $11.3 billion; however, it is not possible to exactly estimate it at present for the lack of data.
3. Different number of REITs based on a source, when combined with CoStar database and DBEDT's REIT survey, DBEDT's total number of REITs in 2014 came up to 42 operating in the state. It is likely, nonetheless, that some of these are branches/subsidiaries of other REITs already counted.

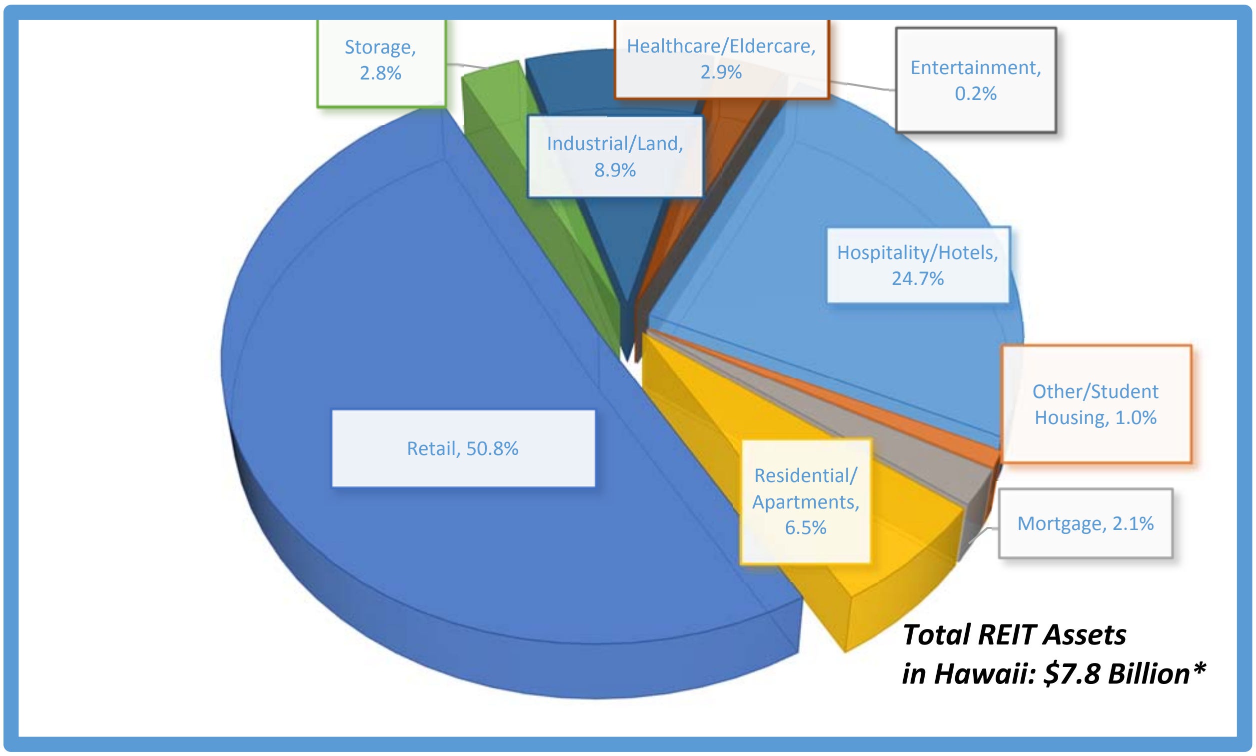
Source: SEC, DOTAX, calculations of asset value by DBEDT

Number of Hawaii-based REITs. Among all of the REITs operating in Hawaii, there was one REIT identified that had its main office in Hawaii in 2014. Although other REITs may derive a substantial portion of their revenue from Hawaii, their main offices are located out-of-state. It is important to note that the quantity of REITs operating in Hawaii varies from year to year, as new REITs enter the state and others pull out.

Another caveat is that this number only represents U.S.-based REITs, operating in Hawaii, and does not include foreign-based REITs, such as J-REITs (Japanese REITs), A-REITs (Australian REITs), or S-REITs (Singapore REITs). The sources used for this analysis did not include data on foreign REITs listed on non-U.S. exchanges. However, unless there is a specific tax agreement or a bilateral treaty, foreign REITs are not be eligible for any special tax treatment in the United States.

Distribution of REITs in Hawaii by Industry. Even though REIT capital is used primarily to acquire real estate, it also supports other sectors of the economy. The graph below shows the reported real estate asset values and the percentages of total asset value by industry for REIT investments. The largest category is retail, with more than half of the total asset value of REIT-owned properties in the state (as reported by 10-K filings). The second largest category was hospitality/hotels with about a quarter of REIT property asset value. Both the retail and hospitality/hotel sectors are significant contributors to Hawaii's economy.

Figure 2. Reported Property Value of REITs in Hawaii by Industry, 2014*



*It is impossible to estimate how the chart's composition would change if using NAREIT's $11.3 billion estimate market value (as of December 2015), since NAREIT's number does not include all of the REITs identified by DBEDT. Therefore, the share represents REIT assets in Hawaii at cost basis as reported by REITs to SEC.

Source: Calculations by DBEDT, based on company filings to SEC

In addition to retail and hospitality/hotel sectors, based on SEC data, REIT investments reach a broad base of other industries. Sectors with rapidly expanding investments include mortgage REITs, healthcare-focused REITs, hospitality/hotel REITs, and storage REITs. ***Mortgage REITs***, even though they still account for a relatively small part of the total portfolio (just above 2%), increased their investments by 936% in Hawaii between 2011 and 2014.

Currently, REITs specializing in ***healthcare/eldercare*** properties account for about 3% of total REIT investment in the state. However, the amount invested in healthcare/eldercare properties by REITs nearly doubled between 2011 and 2014, increasing by 89%.

REITs investing in the ***hospitality/hotel*** sector, continue to be drawn to the isles by the excellent revenue potential of Hawaiian properties and have also strongly increased investments in the state's economy between 2011 and 2014 by over 74%.

REITs investing in ***storage*** facilities, currently at about 2.6% of total REIT investment capital flowing into the state, have also registered large increases in investment, growing by 70% between 2011 and 2014.

REIT-owned ***residential/apartment*** properties increased their holdings in Hawaii by more than 25% between 2011 and 2014, highlighting high demand for rental properties during this time period.

There was a slight increase of 3% for REIT-owned ***retail*** and ***entertainment*** properties, between 2011 and 2014. As described above, retail is the largest category for REIT investment in the state.

On the other hand, the REIT holdings of ***industrial and land*** decreased by nearly 8%, between 2011 and 2014. ***Office*** properties owned by REITs, during the same period, decreased by 1% over the period.

V. FISCAL IMPACTS OF REITS IN HAWAII

Fiscal impact on Hawaii due to Dividend Paid Deduction (DPD) provision for REITs.

In order to measure the fiscal impacts of the REIT DPD, the following two steps were used to develop estimates:

1. Identify REITs operating in Hawaii. This was done by researching the SEC's EDGAR database and the CoStar database (performed by DBEDT) and researching an I.R.S. 2014 business database (performed by DOTAX). A total of 69 potential candidates were identified by the two departments. The REITs identified by DBEDT are listed in Appendix B, while the ones identified by DOTAX cannot be listed due to the confidential nature of the tax data.
2. For the REITs identified in step one, the next step was to tabulate the data from Hawaii Tax Form N-30 (Hawaii Corporate Income Tax) for Tax Years 2009 to 2014 (performed by DOTAX). Since the analysis was based on REITs operating in Hawaii during 2014, some REITs that operated in Hawaii prior to 2014 may not have been included in the analysis.

The method used to estimate foregone taxes was a simple approach of multiplying the effective tax rate by REIT total net income allocated to Hawaii properties, as reported by DOTAX. This approach was used to estimate the top range values for corporate income tax the state could have collected from REITs. For the years 2009 – 2011, the corporate income tax rate used was 6.39%, due to a portion of the dividends being taxed below the highest tax bracket of 6.4%. Additionally, for the years 2012 – 2014 a tax rate of 5% was used, because a portion of the corporate income was from capital gains in addition to operational income. Capital gains are taxed at 4%, and the midpoint between the corporate income tax rate and the capital gains tax rate is about 5%. Based on this methodology, total maximum corporate income tax foregone by the State of Hawaii in 2014 due to REIT dividend paid deduction was approximately $36 million (total net REIT income – Hawaii share, $720.6 million, multiplied by the effective average corporate income tax rate of 5%), with an average annual amount of about $9.6 million between 2009 and 2014.

Table 2. REIT Income in Hawaii and Maximum Corporate Income Tax Foregone, 2009–2014

REIT Total Income, Net Income Before Adjustments, and Hawaii Share for TY's 2009-2014 (C-Corporations only), in millions of $*					
Tax Year	Estimated Number of REITs	Total U.S. Income	HI Share of Total Income	HI Share of Net Income**	Estimated Maximum Corporate Income Tax Foregone
2009	28	$9,139.20	$93.3	$4.70	$0.3
2010	31	$9,022.70	$240.4	$57.90	$3.7
2011	29	$10,519.90	$333.7	$50.30	$3.2
2012	34	$13,913.60	$317.5	$79.90	$4
2013	33	$19,061.90	$598.2	$208.80	$10.4
2014	33	$24,608.80	$1,031.6	$720.60	$36

* Net income is income before any adjustments (such as tax credits or deductions for dividends paid). Only positive net incomes are included in the total. The Hawaii share is based on the average of property, payroll and sales shares.

**DBEDT treats net income as taxable income here in calculating tax impact.

Source: DOTAX; corporate income tax estimates by DBEDT

It is important to note there are some limitations to the estimates above with regards to corporate income tax behavior. Specifically, the estimates do not take into account how REITs would change their behavior if the DPD were repealed. In other words, how would REITs change their tax strategy under the new scenario of REITs being subject to state corporate income tax?

According to the State of Hawaii Department of Taxation:

> **The Department of Taxation believes that if Hawaii 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.**

Total Tax Foregone by the State due to REIT Dividend Paid Deduction

The estimated corporate income tax calculations presented above are not taking into account tax recovered by the State from REIT investors, taxpayers in Hawaii, who pay taxes on income received from REIT dividends, earned on revenue by a REIT's Hawaii operations. In order to calculate the amount of state tax revenue recovered from Hawaii households paying taxes on dividends received from REITs (with property in Hawaii), we used an estimate from the survey data. According to the survey data, between 0.5% (from the resident survey) and 3.0%

(financial professional survey) of Hawaii taxpayer households had investments in REITs which owned property in Hawaii; therefore, we took the mid-point of 1.75% as an estimate (see survey tables).[11]

Table 3. Estimated Fiscal Impact to the State of Hawaii due to Dividend Paid Deduction

	Assumptions	**Results**	
		2014	**Average (2009-2014)**
	Corporate Income Tax Foregone:	**$36,030,000**	**$9,614,023**
A	Estimated number of households invested in REITs with Hawaii property (1.75% of households)	7,888	NA*
B	Average amount of REIT annual dividends per household with REIT investment (mid-point of survey estimates)	$2,421	NA*
C	A x B = Dividend Income	$19,096,848	NA*
D	State tax recovered from dividend income tax paid C x 5% (estimated state income tax rate after deductions)	$954,842	NA*
	Estimated Total Tax Foregone, 2014	**$35,075,158**	**$9,614,023**

*The average amount for 2009-2014 assumes no offset due to a lack of data. However, realistically, this amount would be similar to the amounts reflected for 2014.

Source: Calculations by DBEDT, based on survey results and data from DOTAX

Table 3 presents the scenario for the maximum tax revenue impact to the State of Hawaii, including the offset amount from the in-state residents paying taxes on dividend income associated with Hawaii REITs (offset = $954,842 in 2014). It should be noted that net income for REITs varies significantly from year to year, and offsets would also vary significantly from year to year. Another issue to note is that, in any given year, some REITs may not have any income due to claiming a net loss for the year. For example, in tax year 2013, only twenty of the thirty three REITs, with property in Hawaii, reported positive net income. In summary, the

[11] The 1.75% estimate is multiplied by the number of HI households in 2014. The number of households, was 450,769 for 2014 (U.S. Census Bureau, ACS 1 Year Survey). This results in an estimate for the total number of 7,888 Hawaii households who invest in REITs with properties in Hawaii.

net tax benefit to the State of Hawaii depends on the overall economic conditions and the ability and the extent of REITs to use non-DPD deductions to minimize their tax liabilities.

General excise tax (GET) generated by REIT-owned retail properties. The table below highlights REIT-owned properties in the retail sector. REIT retail entities contribute an estimated $207 million to the state's general fund (the median state GET value per year contributed by the REIT-owned mall/shopping center/outlet is about $5.7 million). The total GET contribution to the state's general fund was calculated using sales data from each shopping center (reported as sales per square foot) multiplied by the size of the mall and by the state's tax rate of 4%.

Table 4. Retail: Estimated Tax Benefit for the State of Hawaii – General Excise Taxes Generated by REIT-owned Malls and Shopping Centers, 2014

Average Sales per Square Foot at REIT-owned Mall/Shopping Center	Average Mall/Shopping Center Size	Estimated Total State GET (at 4.0%)
$938	***516,343 square feet***	***$207,430,551***

Source: Data taken from company annual reports and/or other formal filings, 2014

In addition to retail, other REIT sectors including storage facilities, hotels, healthcare facilities, student dorms, and entertainment are also sources for state tax revenue. However, due to a lack of data, these are difficult to estimate their full contribution to the state's tax base.

VI. SURVEY RESULTS

As described earlier, the basis for this report was Act 239, which mandated an analysis of REITs based on thirteen specific items included in the Act. One of the main research questions of Act 239 was an estimate of Hawaii resident taxpayers who invest in REITs. Furthermore, the Act requested an analysis of the REIT investments regarding property in Hawaii, headquartered in Hawaii, and a breakdown of investors by income and filing status. One of the difficulties in addressing these research questions was the complexity of REITs and a lack of understanding of REIT by the average taxpayer resident. Therefore, it was decided to survey investment and financial companies in addition to Hawaii taxpayers and to provide two estimates, both of which are included in the tables below. While the values of the estimates are similar, the average values of the financial companies provide a more accurate estimate because of their expert understanding of REITs as an investment vehicle.

SURVEY METHODOLOGY – SUMMARY

There were four surveys conducted in order to address the requirements of Act 239 that could not be met with existing data sources.

- The *Residential survey*, or the survey of the Hawaii Resident Taxpayers, was designed to evaluate the extent to which Hawaii residents invest in REITs.
- The *Financial Advisor survey* was intended to complement the REIT Residential Survey by asking financial advisors to estimate how much Hawaii residents invest in REITs.
- The primary objective of the *survey of the Real Estate Investment Trusts* was to identify private REITs not listed in other data sources. The survey also addressed the number and value of REIT-owned properties in Hawaii to supplement other data sources.
- Finally, *REIT industry experts and stakeholders* were surveyed via a Delphi survey, conducted in two waves. The Delphi survey method involves the iterative surveying of a group of individuals regarded as experts in some subject matter. The objective of the *Wave 1* was to obtain opinions from open-ended questions regarding the impact of repealing the DPD. For *Wave 2*, these open-ended responses were summarized into opinion statements, where the respondents could reply agree or disagree.

For more information regarding the methodology, surveys, and response rates for each of the surveys, see ***Appendix D***, ***Survey Methodology and Results***.

1. REIT Ownership by Hawaii Taxpayers

According to IRS Statistics, 20.4% of Hawaii taxpayers reported dividend income for tax year 2014. However, the IRS data does not break out dividend income by REIT dividends. Therefore, DBEDT conducted a survey of Hawaii resident taxpayers regarding their REIT investments and dividends. The survey estimates showed that between 1.8% (direct investment) and 12.8% (indirect investment) of Hawaii taxpayers have some type of REIT investment.[12] Additionally, the survey showed that between 0.5% and 3.0% of Hawaii taxpayers invest in REITs with property in Hawaii.

The results of the taxpayer survey showed that 1.8% of Hawaii taxpayers held direct REIT investments in 2014 (Table 5). The results from the investment professional survey were higher, at 3.7% for REIT direct investments. The survey also asked about indirect REIT investments. In other words, investments such as mutual funds, exchange traded funds, or other investment vehicles that include REITs within a larger portfolio. The results of the investment professional survey showed that an average of 12.8% of Hawaii taxpayers had indirect REIT investments. The resident taxpayer survey showed a lower amount, with an average of 2.5% with indirect REIT investments. The difference in these results could be explained by the fact that Hawaii residents did not fully understand the question on REITs and indirect investments; therefore, the investment professional survey provides a more accurate estimate.

In addition to REIT investments in general, it is also important to identify what percentage of Hawaii taxpayers invest in REITs *with property in Hawaii*. The resident taxpayer survey showed an estimated 0.5%, and the investment professional survey showed an estimated 3.0% of Hawaii taxpayers have REIT investments with property in Hawaii. The results were also relatively low for investment in REITs headquartered in HI, with the taxpayer survey at 0.6% and the investment professional survey at 1.3%. Due to their understanding of REIT investments, the investment professional estimates are probably more accurate.

[12] REIT investors do not always receive dividends, since some REITs may choose not to pay out dividends if they are incur operating loss.

Table 5. Percentage of Hawaii Taxpayers with REIT Investments, 2014
(Based on Act 239 items 3 and 4)

	Residents	Financial Professionals – estimates of Hawaii residents investors in REITs
Direct Investment in REIT	1.8%	3.7%
Indirect Investment in REIT	2.5%	12.8%
Percent Invested in REITs with Property in Hawaii	0.5%	3.0%
REITs headquartered in Hawaii	0.6%	1.3%

Source: REIT Survey – Residents/Financial Professionals, 2016, DBEDT

2. REIT Investment Amounts of Hawaii Taxpayers

The surveys also addressed the average amount of REIT investments held by Hawaii taxpayers. The taxpayer survey had an average value of REIT investments of $15,983, which was below the investment professional estimate of $22,867. It is important to note that these results were estimates for taxpayers that held REIT investments, rather than for all taxpayers in Hawaii.

Table 6. Average REIT Investment and Dividend Amounts for Hawaii Taxpayers, 2014
(Additional information for Act 239 items 3 and 4)

	Resident estimates	Financial Professionals estimates
Average amount invested in REITs	$15,983	$22,867
Average amount of dividends received from REITs	$966	$3,875
Estimate of Avg. yield, 2014	6.04%	16.9%

Source: REIT Survey – Residents/Financial Professionals, 2016, DBEDT

Another requirement of Act 239 was to estimate REIT investments by income and tax filing status. The results showed that the average investment amount of Hawaii taxpayers with REIT investments was $15,983. The resident taxpayer survey results showed that the average REIT investment for Hawaii REIT investors was $12,861 for households with incomes below $100,000 and $42,048 for households with incomes of $100,000 and above.

It is important to note, that these averages only include *individual resident REIT investors* (individuals and households) and do not include *institutional or corporate investors*.

Table 7. Average REIT Investment Amount by Household Income, 2014
(Based on Act 239 item 5)

Resident Category by Household Income*	Percent Distribution	Average Amount of REIT Investments by Tax Status
Below $100,000	89.2%	$12,861
$100,000 and Above	10.8%	$42,048
Total	**100%**	**$15,983**

* Weighted by adjusted gross income

Source: REIT Survey – Residents/Financial Professionals, 2016, DBEDT

Table 8 summarizes REIT investment by filing status. The Married Filing Separately category had by far the highest average value at $81,748, and the Single category had the lowest average at $10,124. The reason for this wide gap may that married-households with large investments tend to file separately due to more advantageous tax implications for their investments.

8. Average REIT Investment Amount by Tax Filing Status for Hawaii Taxpayers, 2014
(Based on Act 239 item 5)

Resident Category by Tax Filing Status*	Percent Distribution	Average Amount of REIT Investments by Tax Status
Single	33.5%	$10,124
Joint	52.6%	$10,183
Married, file separately	8.1%	$81,748
Other**	5.8%	$10,224
Total	**100.0%**	**$15,983**

* Weighted by adjusted gross income**Includes categories such as “head of household” and “qualified widower”

Source: REIT Survey – Residents/Financial Professionals, 2016, DBEDT

3. Stakeholder and Industry Expert Opinions Regarding REITs and Hawaii Economy

In addition to the quantitative information above, Act 239 also included a qualitative dimension of Hawaii REIT investments, such as whether REITs are beneficial for small investors and if they are fair and equitable from an overall state and investor perspective. The opinion surveys also provided insight into how REITs would react if the Dividend Paid Deduction (DPD) was repealed. Two surveys were targeted at Hawaii REIT stakeholders and industry experts (see the ***Methodology*** section, Appendix D). From a research perspective, it should be noted that this was not a random sample. The survey included REIT companies, non-REIT real estate investment companies, Hawaii residents that had submitted testimony, and others (such as academics specializing in real estate, lawyers, business executives, industry organizations). The purpose of this survey was to collect opinions from those that had already expressed an interest in REITs through testimony or those identified as industry experts. The survey results were analyzed and the results are as follows:

1. As shown in Table 9, a majority of industry experts and stakeholders indicated that ***REITs provide a good opportunity for small investors*** in that they allow small investors to invest in large-scale real estate developments. This result was fairly consistent, with a majority within each respondent group indicating that REITs are a good opportunity for small investors.

Table 9. Are REITs a Good Opportunity for Small Investors?

Actual Survey Question: *Do REITs provide a good opportunity for small investors by allowing them to invest in large real estate developments – similar to mutual funds invested in stocks?* (Based on Act 239 item 8)

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Resident Taxpayer	Other
Yes	10 (76.9%)	5 (100%)	6 (85.7%)	15 (75.0%)
No	3 (23.1%)	0	1 (14.3%)	3 (15.0%)
No Opinion	0	0	0	2 (10.0%)
Total	**13 (100%)**	**5 (100%)**	**7 (100%)**	**20 (100%)**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

2. The next topic was focused on the question of whether ***the State would lose tax revenue via Transfer Pricing if the DPD were repealed.*** Before outlining these results, it is first

important to ***define transfer pricing***. Transfer pricing is the setting of a price for goods and services sold between related legal entities such as a parent to a subsidiary company (McKinley, 2013). The purpose of transfer pricing is to shift income from a higher tax jurisdiction to a lower tax jurisdiction. An example of a transfer pricing dispute is Louisiana Department of Revenue challenging Autozone for allegedly transferring income from Louisiana (higher state corporate income tax) to a related entity in Nevada (no corporate income tax) in order to minimize state taxation (Supreme Court of Louisiana, 2005). The following table presents results of the analysis of the question: if the REIT DPD were repealed, would Hawaii lose tax revenue via transfer pricing? The results in the table show a split between REIT and non-REIT real estate investors, with a majority of REITs indicating that the state would lose tax revenue if the DPD were repealed and non-REIT real estate investors indicating that there would be no tax revenue loss. The residents and other categories indicated that the State would not lose tax revenue via transfer pricing if the DPD were repealed.

Table 10. Impact on State Tax Revenue from <u>Transfer Pricing</u> if DPD were Repealed?

Actual Survey Question: *Would State lose tax revenue via transfer pricing if DPD were repealed?* (Based on Act 239 item 9)

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Resident Taxpayer	Other
Yes	2 (15.4%)	5 (100%)	2 (33.3%)	6 (28.6%)
No	8 (61.5%)	0	3 (50.0%)	11 (52.4%)
No Opinion	3 (23.1%)	0	1 (16.7%)	4 (19.0%)
Total	**13 (100%)**	**5 (100%)**	**6 (100%)**	**21 (100%)**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

3. Another question ***assessed the impact of repealing the DPD on real estate investment in Hawaii over 5 years***; would there be a decrease in investment or no change? The five REIT respondents represented approximately 40% of the $7.8 billion of REIT investment in Hawaii, with companies in the major REIT sectors. Four of the five REIT companies indicated that real estate investment would decrease between 11% and 30%, within five years. On the other hand, a majority of the non-REIT real estate investors (61.5%) indicated there would be no impact on real estate investment if the DPD were repealed.

Over half of the resident taxpayers (57%) responded that there would be no change, 50% of the other category indicated there would be no change, and the remaining indicated there would be a decrease or they did not know. This survey question provides insight into how REITs would react if the DPD were repealed.

Table 11. Impact of DPD Repeal on Real Estate Investment Over Five Years

Actual Survey Question: *If the DPD was repealed, what impact would that have on real estate investment in Hawaii over 5 years?*(Based on Act 239 items 12 and 13)

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Resident Taxpayer	Others
No Change	9 (64.3%)	0	4 (57.1%)	10 (47.6%)
Decrease by 0% to 5%	1 (7.1%)	0	1 (14.3%)	1 (4.8%)
Decrease by 6% to 10%	0	0	0	2 (9.5%)
Decrease by 11% to 20%	1 (7.1%)	2 (40.0%)	1 (14.3%)	0
Decrease by 21% to 30%	0	2 (40.0%)	0	1(4.8%)
Decrease by more than 30%	1 (7.1%)	0	0	2 (9.5%)
Don't Know	2 (14.3%)	1 (20.0%)	1 (14.3%)	5 (23.8%)
Total	**14 (100%)**	**5 (100%)**	**7 (100%)**	**21 (100%)**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

4. A question seeking to determine ***whether or not DPD is equitable*** was asked of the experts/stakeholders to gauge whether or not REITs are on the same level of the "playing field" with other real-estate investors (non-REIT) in Hawaii. The equity question was split between REITs and non-REITs, with REITs expressing the opinion it is equitable (100%) and a majority of non-REITs expressing that it is not equitable (71.4%). Resident taxpayers also did not feel it was equitable (85.7%) and the others category was mixed.

Table 12. Is DPD Equitable for Hawaii Overall?

Actual Survey Question*: Is the REIT Dividend Paid Deduction (DPD) equitable for the State of Hawaii overall?*

(Based on Act 239 item 10)

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Resident Taxpayer	Other
Yes	4 (28.6)	5 (100%)	0	6 (28.6%)
No	10 (71.4%)	0	6 (85.7%)	12 (57.1%)
Don't Know	0	0	1 (14.3%)	3 (14.3%)
Total	**14 (100%)**	**5 (100%)**	**7 (100%)**	**21 (100%)**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

5. Experts and stakeholders were asked if the DPD was ***an efficient tool to allocate capital investment***. As outlined earlier, REITs must pay out at least 90% of their income in dividends to shareholders and these dividends are not subject to state and federal corporate income tax. On the other hand, non-REIT real estate investors are subject to state and federal corporate income tax, even if the income is paid out as dividends to shareholders. The purpose of this question was to get opinions regarding if allowing REITs to deduct dividends paid is an efficient tool to allocate capital. As with the equity question, the efficiency question was largely split between REITs and non-REITs, with all REITs responding that it is efficient and a majority of non-REITs indicating that it is not an efficient tool to allocate capital. The follow up open-ended responses to this question showed similar opinions for both the equity and the efficiency questions. It appears that the respondents saw equity and efficiency as a combined concept, rather than two different dimensions.

Table 13. Is the DPD an Efficient Tool to Allocate Capital Investment?

Actual Survey Question: *Is the REIT Dividend Paid Deduction (DPD) an Efficient Tool to Allocate Capital Investment?*

(Based on Act 239 item 10)

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Residents	Others
Yes	6 (42.9%)	4 (100%)	1 (14.3%)	9 (42.9%)
No	8 (57.1%)	0	4 (57.1%)	10 (47.6%)
Don't Know	0	0	2 (28.6%)	2 (9.5%)
Total	**14 (100%)**	**4 (100%)**	**7 (100%)**	**21 (100%)**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

Wave 2 of the Delphi Survey.

A second part of the Delphi opinion survey was conducted to the same group of industry experts and stakeholders as the first Delphi survey (see methodology section in appendix). The purpose of the second Delphi survey was to design specific agree/disagree survey questions from open-ended responses received in the first Delphi survey.

This section is organized in three parts:

- **Part A.** Analyzes REITs from the individual investor perspective.
- **Part B.** Looks at the potential impact of repealing the DPD on Hawaii's real estate market.
- **Part C.** Analyzes the potential impact of repealing the DPD on state tax revenue.

Table 14-A. Do REITs Benefit Local Investors and Do They Bring Capital to Hawaii?

1. Survey Statement: *The DPD results in mainland REIT investors gaining more financial benefit from Hawaii than Hawaii receives in return.*

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Residents	Others
Agree	8 (88.9 %)	0	2 (66.7%)	4 (44.4%)
Disagree	1 (11.1%)	3 (100%)	1 (33.3%)	5 (55.6%)
Total	**9**	**3**	**3**	**9**

2. Survey Statement: *REITs increase the flow of capital into Hawaii for property investment which benefits the state.*

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Residents	Others
Agree	4 (44.4%)	3 (100%)	1 (33.3%)	5 (55.6%)
Disagree	5 (55.6%)	0	2 (66.7%)	4 (44.4%)
Total	**7**	**3**	**3**	**9**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

Part B statements dealt with the issue of whether Hawaii will remain an attractive destination for investments – especially for REITs – given the scale of investments in the state currently and planned additional investments. Another statement sought to address the issue of the likely negative impact on investments in general, and real estate investments in particular, once DPD repeal is implemented in Hawaii. Finally, a statement addressing a concern that out of state investors, especially REITs, inflate property values in Hawaii, because of their different investment focus (such as a search for a steady investment income, which could potentially justify REITs' willingness to pay prices higher than market fundamentals, as opposed to just focusing on market value for likely resale purposes for regular real estate investors).

Table 14-B. With no DPD, is Hawaii Still Attractive as REIT Investment Destination?

1. Survey Statement: *If the DPD were repealed, Hawaii would still be an attractive market for real estate investors*.

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Residents	Others
Agree	9 (100%)	1 (33.3%)	1 (33.3%)	6 (66.7%)
Disagree	0	2 (66.7%)	2 (66.7%)	3 (33.3%)
Total	**9**	**3**	**3**	**9**

2. Survey Statement: *Repealing the DPD would have a negative impact on Hawaii's reputation as an investment-friendly environment.*

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Residents	Others
Agree	9 (100%)	1 (33.3%)	1 (33.3%)	6 (66.7%)
Disagree	0	2 (66.7%)	2 (66.7%)	3 (33.3%)
Total	**9**	**3**	**3**	**9**

3. Survey Statement: *The DPD distorts Hawaii property values*.

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Residents	Others
Agree	7 (77.8%)	0	2 (66.7%)	3 (33.3%)
Disagree	2 (22.2%)	3 (100%)	1 (33.3%)	6 (66.7%)
Total	**9**	**3**	**3**	**9**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

Part C statements were designed to gauge the potential impact on tax revenue if the DPD were repealed. It also examined opinions regarding if REITs contribute their share of state taxes or not. Another question examined whether REITs bring a net benefit to the state by paying GET and property taxes.

Table 14-C. Do REITs Contribute Their Fair Share to the State in Tax Payments?

1. Survey Statement: *The DPD prevents Hawaii from receiving an appropriate amount of corporate income tax benefit from REIT investments.*

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Residents	Others
Agree	8 (88.9 %)	0	2 (66.7%)	5 (55.6%)
Disagree	1 (11.1%)	3 (100%)	1 (33.3%)	4 (44.4%)
Total	**9**	**3**	**3**	**9**

2. Survey Statement: *REITs pay taxes including general excise tax and property tax which brings a net benefit to Hawaii.*

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Residents	Others
Agree	3 (42.9 %)	3 (100%)	2 (66.7%)	6 (66.7%)
Disagree	4 (57.1%)	0	1 (33.3%)	3 (33.3%)
Total	**9**	**3**	**3**	**9**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

Caveats to Survey Results

There are important caveats to note with regard to all survey results:

1. Small sample size.
2. Low response rate.
3. Weighting issue – the responses received were not weighted to account for the fact that one respondent may represent a large group of constituents or a large organization.

In summary, the survey recipients were contacted multiple times to ensure the highest response rate possible. However, many of the entities contacted were hesitant to respond to the survey, which resulted in a lower than expected response rate.

SUMMARY

The findings of our research are the following:

- 42 REITs were identified operating in Hawaii (37 via US Securities and Exchange Commission filings, 3 more via Costar, a commercial real estate database, and 2 via surveys).
- Only one REIT had its main office in Hawaii.
- Total assets for the REITs identified were estimated at $7.8 billion at cost basis (10-k filings). However, this amount does not reflect the current market value of the properties.
- 50.8% of the assets were in the retail industry and 24.7% were in hospitality related industries.
- According to the estimate from DOTAX, net income for REITs with property in Hawaii increased 2.6 times between 2012 and 2013, from $79.9 million in 2012 to $208.8 million in 2013, and by nearly 3.5 times between 2013 and 2014, from $208.8 million to $720.6 million.
- Estimated corporate income tax revenue foregone by the State of Hawaii due to REIT dividend paid deduction were estimated between $0.3 million in 2009 and $36 million in 2014 ($35 million accounting for tax offset from REIT dividends received by Hawaii residents). These amounts will vary with economic conditions.
- An average amount in corporate income taxes foregone by state between 2009 and 2014 is estimated to be around $9.6 million per year.
- The retail sales from REIT properties in Hawaii (50.8% of the total REITs) generated an estimated $207 million in State General Excise Tax (GET) in 2014.
- The survey estimates showed that between 1.8% (direct investment) and 12.8% (indirect investment) of Hawaii resident taxpayer households receive income from REIT dividends, which is between 8,114 and 57,698 households.
- Additionally, between 0.5% and 3.0% of Hawaii taxpayers invest in REITs *with property in Hawaii*. This results in a total of between 2,254 and 13,523 household investors in REITs with property in Hawaii.
- The resident taxpayer survey showed that the average REIT investment for Hawaii-resident REIT investors was $12,861 for households with incomes below $100,000 and $42,048 for households with incomes of $100,000 and above.

- The “Married Filing Separately” category had the highest average investment in REIT, at $81,748, and the “Single” category had the lowest average investment at $10,124.
- REITs indicated that, if the DPD were repealed, real estate investment in Hawaii would decrease by between 11% and 30 % within five years. In contrast, a majority of non-REIT real estate companies indicated there would be no change in real estate investment within five years of repealing the DPD.

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APPENDIX A: ANSWERS ACT 239 QUESTIONS/REQUIREMENTS

(1) The total number of real estate investment trusts that operate in Hawaii.

Based on combined data from the US Securities and Exchange Commission and private database owned by CoStar Group, 40 REITs were identified that had operations Hawaii in 2014. Two additional REITs were identified through a survey.

(2) Of that total in paragraph (1), the number that are Hawaii-based.

According to the US Securities and Exchange Commission, there was one REIT, whose main office was located in Honolulu, HI – Pacific Office Properties, Inc. This finding was also confirmed by the survey.

(3)The number of Hawaii taxpayers who are investors in real estate investment trusts that operate in Hawaii.

The survey results show that in Hawaii between 1.8% and 12.8% have the potential to receive income from REIT dividends (Table A.1).[13] Based on Census data, the state of Hawaii had 450,769 households in 2014. Applying the survey results in a number of REIT investors in Hawaii of between 8,114 and 57,698 households.

Table A.1. Percentage of Hawaii Taxpayers with REIT Investments, 2014
(Based on Act 239 items 3 and 4)

	Residents	Financial Professionals – estimates of Hawaii residents investors in REITs
Direct Investment in REIT	1.8%	3.7%
Indirect Investment in REIT	2.5%	12.8%
Percent Invested in REITs with Property in Hawaii	0.5%	3.0%
REITs headquartered in Hawaii	0.6%	1.3%

Source: REIT Survey – Residents/Financial Professionals, 2016, DBEDT

(4) The number of Hawaii taxpayers who are investors in Hawaii-based real estate investment trusts that operate in Hawaii.

As Table A.1 (above) indicates, between 0.5% and 3.0% of Hawaii taxpayers invest in REITs with property in Hawaii. This results in a total of between 2,254 and 13,523 household investors in REIT, which are based in Hawaii.

(5) A breakdown of Hawaii taxpayers who are investors in Hawaii-based real estate investment trusts that operate in Hawaii, by filing status and income.

The resident taxpayer survey results showed that the average REIT investment for Hawaii REIT investors was $12,861 for households with incomes below $100,000 and $42,048 for households with incomes of $100,000 and above.

[13] REIT investors do not always receive dividends, since some REITs may choose not to pay out dividends if they are incur operating loss.

It is important to note that these averages only include *individual resident REIT investors* (individuals and households) and not *institutional or corporate investors*.

Table A.2. Average REIT Investment Amount by Household Income, 2014

Resident Category by Household Income*	Percent Distribution	Average Amount of REIT Investments by Tax Status
Below $100,000	89.2%	$12,861
$100,000 and Above	10.8%	$42,048
Total	**100%**	**$15,983**

* Weighted by adjusted gross income

Source: REIT Survey – Residents/Financial Professionals, 2016, DBEDT

Table A.3 summarizes REIT investment by filing status. The Married Filing Separately category had by far the highest average value at $81,748, and the Single category had the lowest average at $10,124. The reason for this wide gap may that married-households with large investments tend to file separately due to more advantageous tax implications for their investments.

Table A.3. Average REIT Investment Amount by Tax Filing Status for Hawaii Taxpayers, 2014

Resident Category by Tax Filing Status*	Percent Distribution	Average Amount of REIT Investments by Tax Status
Single	33.5%	$10,124
Joint	52.6%	$10,183
Married, file separately	8.1%	$81,748
Other**	5.8%	$10,224
Total	**100.0%**	**$15,983**

* Weighted by adjusted gross income**Includes categories such as "head of household" and "qualified widower"Source: REIT Survey – Residents/Financial Professionals, 2016, DBEDT

(7) A comprehensive examination of captive real estate investment trusts for companies operating in Hawaii.

Although 42 REITs (as end-2014) operating in Hawaii were identified, DBEDT was unable to identify captive REITs in Hawaii in 2014 (Costar Database, 2015). Furthermore, rent revenue is subject to Hawaii's General Excise Tax, even for REITs, and this reduces the incentive to set up a captive REIT structure. Hawaii does not allow the DRD, as explained in testimony by Maria E. Zielinski, Director of Department of Taxation "…a dividend paid by a REIT is not considered a 'dividend' for purposes of HRS section 235-7(c), and the dividend received deduction is not allowed for Hawaii income tax purposes (Department of Taxation Testimony, 2015)".[14] Director Zielinski's testimony also includes a proposed measure to limit captive REITs ability to benefit from the dividend paid deduction by stipulating that "dividends paid

[14] Maria E. Zielinski, Department of Taxation. February 18, 2015. Testimony for the Honorable Jill N. Tokuda Chair and Members of the Senate Committee on Ways and Means.

shall not apply to a captive real estate investment trust." The proposed measure used a definition similar to the captive REIT definition of the Multistate Tax Commission definition.

There were no captive REITs identified in Hawaii in 2014. Previously, Howard Hughes operated a captive REIT in Hawaii, called Victoria Ward Limited, mentioned in its 2013 10-K filing with the Securities and Exchange Commission. Victoria Ward Limited was re-organized in 2014 and is no longer a captive REIT. A couple of other REITs, which are owned by large retailers, such as Seritage (owned by Sears) and Darden's REIT unit (Darden is an owner of national franchises, such as Olive Garden and other restaurants), were formed in 2015 and 2016 respectively – years not analyzed in the current report. However, there is currently no reason to suspect either REIT of being a captive REIT, since both are trading on stock exchanges and were spun off by their parent companies to be independent real estate investment companies, separate from the main business of the parent organization.

(*For a more complete information, please refer to Section III, Captive REITs in the report*).

(8) An examination of the argument that real estate investment trusts provide opportunities for small investors to pool funds with others and invest in real estate developments, similar to investments through mutual funds invested in company stocks.

Most REITs that operate in Hawaii are publicly-traded and, therefore, provide an opportunity for small investors to invest in large-scale real estate projects. In fact, many small investors may not know that they invest in REITs, because they invest indirectly in REITs through mutual funds with REIT holdings.

Additionally, as shown in Table A.4, according to the survey results, a majority of industry experts and stakeholders indicated that ***REITs provide a good opportunity for small investors*** in that they allow small investors to invest in large real estate developments. This result was consistent across all categories.
(*For a more complete information, please refer to Section on Survey Results*).

Table A.4. Are REITs a Good Opportunity for Small Investors?

Actual Survey Question: *Do REITs provide a good opportunity for small investors by allowing them to invest in large real estate developments – similar to mutual funds invested in stocks?*

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Resident Taxpayer	Other
Yes	10 (76.9%)	5 (100%)	6 (85.7%)	15 (75.0%)
No	3 (23.1%)	0	1 (14.3%)	3 (15.0%)
No Opinion	0	0	0	2 (10.0%)
Total	**13 (100%)**	**5 (100%)**	**8 (100%)**	**20 (100%)**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

(9) An examination of the possible transfer pricing if the dividend paid income tax deduction for real estate investment trusts is repealed

This question examined the possibility of REITs transferring corporate income to out-of-state locations due changes in tax law. The opinion survey results in Table A.5 show a split between REIT and non-REIT real estate investors, with a majority of REITs indicating that the state would lose tax revenue if the DPD were repealed and non-REIT real estate investors indicating that there would be no tax revenue loss. The residents and other categories indicated that the State would not lose tax revenue via transfer pricing if the DPD were repealed.

(For a more complete analysis see Section on Survey Results, Point 2 – analysis of Transfer Pricing issue in the context of REIT survey).

Table A.5. Impact on State Tax Revenue from Transfer Pricing if DPD were Repealed?

Actual Survey Question: *Would State lose tax revenue via transfer pricing if DPD were repealed?*

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Resident Taxpayer	Other
Yes	2 (15.4%)	5 (100%)	2 (33.3%)	6 (28.6%)
No	8 (61.5%)	0	3 (50.0%)	11 (52.4%)
No Opinion	3 (23.1%)	0	1 (16.7%)	4 (19.0%)
Total	**13 (100%)**	**5 (100%)**	**6 (100%)**	**21 (100%)**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

(l0) An examination of the equity and efficiency of the dividends paid income tax deduction for real estate investment trusts

According to the opinion survey of the experts/stakeholders, most agree that overall, DPD is not equitable for the State of Hawaii, even though a third of respondents (31%) thought that DPD was equitable. It is also worth noting that respondents who thought that DPD was equitable were spread across both REITs and non-REITs, as well as other stakeholders, as Table A.6 highlights.

Table A.6. Is DPD Equitable for Hawaii Overall?

Actual Survey Question: Is the REIT Dividend Paid Deduction (DPD) equitable for the State of Hawaii overall?

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Resident Taxpayer	Other
Yes	4 (28.6)	5 (100%)	0	6 (28.6%)
No	10 (71.4%)	0	6 (85.7%)	12 (57.1%)
Don't Know	0	0	1 (14.3%)	3 (14.3%)
Total	**14 (100%)**	**5 (100%)**	**7 (100%)**	**21 (100%)**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

As Table A.7 demonstrates, answers to the question on efficiency of REIT DPD to allocate capital investment depended largely on who was asked. The survey also asked why respondents responded the way they did. These responses were very similar for both the equity question and the efficiency questions, indicating that the respondents saw equity and efficiency as a combined concept, rather than two different dimensions.

Table A.7. Is DPD an Efficient Tool to Allocate Capital Investment?

Actual Survey Question: *Is the REIT Dividend Paid Deduction (DPD) an Efficient Tool to Allocate Capital Investment?*

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Residents	Others
Yes	6 (42.9%)	4 (100%)	1 (14.3%)	9 (42.9%)
No	8 (57.1%)	0	4 (57.1%)	10 (47.6%)
Don't Know	0	0	2 (28.6%)	2 (9.5%)
Total	**14 (100%)**	**4 (100%)**	**7 (100%)**	**21 (100%)**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

(11) The projected tax revenue impact to the State if the dividends paid income tax deduction for real estate investment trusts is repealed

In 2014, the total amount of taxes the State of Hawaii could have collected from REITs if they had been subjected to a corporate income tax is an estimated $36 million (total net REIT income –Hawaii share of $720.6 million multiplied by the effective average corporate income tax rate of 5%) – see Table A.9 below for more details; also Section V, Fiscal Impacts of REITs in Hawaii. Therefore, the amount of corporate income tax foregone by the state varies between $0.3 million in 2009 and approximately $36 million in 2014. These amounts vary depending on economic conditions in a given year. For example, in tax year 2013, only twenty of the thirty three REITs with property in Hawaii reported positive net income.

$720,600,000

(REIT cumulative positive net income in Hawaii)

X

5%

(An approximate average of corporate income tax rate + capital gains tax rate, 2012-2014)

=

-$36,030,000

(Potential tax impact to the State of Hawaii due to DPD), maximum corporate income tax estimate

As Table A.8 notes, the tax impact of REIT DPD on the state– depending on a year – is a foregone benefit of between $0.3 million (2009) and $36 million (2014), averaging about $9.6 million per year.

Table A.8. REITs in Hawaii –Estimated Impact on Corporate Income Tax to the State of Hawaii due to Dividend Paid Deduction, 2009 – 2014

REIT Total Income, Net Income Before Adjustments, and Hawaii Share for TY's 2009-2014 (C-Corporations only), $ in millions*					
Tax Year	Estimated Number of REITS	Total US Income	HI Share of Total Income	HI Share of Net Income**	Estimated Maximum Corporate Income Tax
2009	28	$9,139.20	$93.3	$4.70	$0.3
2010	31	$9,022.70	$240.4	$57.90	$3.7
2011	29	$10,519.90	$333.7	$50.30	$3.2
2012	34	$13,913.60	$317.5	$79.90	$4
2013	33	$19,061.90	$598.2	$208.80	$10.4
2014	33	$24,608.80	$1,031.6	$720.60	$36

* Net income is income before any adjustments (such as tax credits or deductions for dividends paid). Only positive net incomes are included in the total. The Hawaii share is based on the average of property, payroll and sales shares.

**DBEDT treats net income as taxable income in calculating tax impact.

Source: DOTAX, corporate income tax estimated by DBEDT

However, there are some major drawbacks to this simple approach with regards to corporate income tax behavior. Specifically, the approach does not take into account how REITs would change their behavior if the DPD were repealed. In other words, how would REITs change their tax strategy under the new scenario of REITs being subject to state corporate income tax?

According to the State of Hawaii Department of Taxation:

> **The Department of Taxation believes that if Hawaii 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.**

Total Tax Foregone by the State due to REIT Dividend Paid Deduction

The estimated corporate income tax calculations presented above are not taking into account tax recovered by the State from REIT investors, taxpayers in Hawaii, who pay taxes on income received from dividends on income earned by a REIT in Hawaii. In order to calculate the amount of state tax revenue recovered from Hawaii households paying taxes on dividends received from REITs (with property in Hawaii), we used an estimate from the survey data. According to the survey data, between 0.5% (from the resident survey) and 3.0% (financial professional survey) of Hawaii taxpayer households had investments in REITs which owned property in Hawaii; therefore, we took the mid-point of 1.75% as an estimate (see survey tables).[15]

[15] The 1.75% estimate is multiplied by the number of HI households in 2014. The number of households, was 450,769 for 2014 (U.S. Census Bureau, ACS 1 Year Survey). This results in an estimate for the total number of 7,888 Hawaii households who invest in REITs with properties in Hawaii.

Table A.9. Estimated Impact to the State of Hawaii due to Dividend Paid Deduction, 2014

	Assumptions	Results	
		2014	Average (2009-2014)
	Corporate Income Tax Foregone	$36,030,000	$9,614,023
A	Estimated number of household with REIT investments with Hawaii property (1.75% of households)	7,888	NA*
B	Average amount of REIT annual dividends per household with REIT investment (mid-point of survey estimates)	$2,421	NA*
C	A x B = Dividend Income	$19,096,848	NA*
D	State tax recovered from dividend income tax paid C x 5% (estimated state income tax rate after deductions)	$954,842	NA*
	Estimated Total Tax Foregone, 2014	**$35,075,158**	**$9,614,023**

* Since there is no reliable data to estimate amount of REIT annual dividends per household, the average amount for 2009-2014 assumes no offset. However, realistically, this amount would be lower, similar to the amounts reflected for 2014.

Source: Calculations by DBEDT, based on survey results and data from DOTAX

As Table A.9 indicates, the final estimate of taxes foregone in 2014, due to the DPD, will decrease by the amount of $954,842 for a net of about $35 million at the maximum. It is important to note that similar offsets would also occur for the other years listed in Table A.8. Therefore, net tax benefit to the State of Hawaii would depend on the overall economic conditions and the ability and the extent of REITs to use all available deductions to minimize their tax liabilities. These conditions could be volatile, as Table A.8 indicates: net income for REITs varies significantly from year to year.

With regard to question 9, it is hard for DBEDT to estimate exactly how each company may change their behavior in response to an increase in taxes. However, as responses to question 9 and question 12 (below) show, REITs indicated in the opinion survey that there will be a decrease of their investments in Hawaii should the DPD be repealed.

(6) The direct and indirect impacts of real estate investment trusts on the Hawaii economy, especially in real estate development and operation

(12) The impact on the real estate development market and capacity if the dividends paid deduction for real estate investment trusts is repealed.

(13) The impact on the economy of the state if the dividends paid deduction for real estate investment trusts is repealed.

The five REITs that responded to the survey indicated that their Hawaii *real estate investment amount would decrease between 11 and 30% over the next 5 years if the DPD were repealed.* The five REITs that responded represented approximately 40% of the $7.8 billion of REIT investment in Hawaii (on cost basis – see section on Hawaii REIT Analysis). On the other hand, a majority of the non-REIT real estate investors (64.3%) indicated there would be *no impact on real estate investment* if the DPD were repealed. Over half of the resident taxpayers (57%) responded that there would be no change, 50% of the other category indicated there would be no change, and the remaining indicating there would be a decrease or they did not know.

This survey question provided insight into how REITs (in their own view) would react if the DPD were repealed, with all the REITs stating that there would be a decrease in real estate investment.

Table A.10. Impact of DPD Repeal on Real Estate Investment Over Five Years

Actual Survey Question: *If DPD were repealed, what impact would that have on real estate investment in Hawaii over 5 years?*

	Non-REIT Real Estate Investors	REIT Real Estate Investors	Resident Taxpayer	Others
No Change	9 (64.3%)	0	4 (57.1%)	10 (47.6%)
Decrease by 0% to 5%	1 (7.1%)	0	1 (14.3%)	1 (4.8%)
Decrease by 6% to 10%	0	0	0	2 (9.5%)
Decrease by 11% to 20%	1 (7.1%)	2 (40.0%)	1 (14.3%)	0
Decrease by 21% to 30%	0	2 (40.0%)	0	1(4.8%)
Decrease by more than 30%	1 (7.1%)	0	0	2 (9.5%)
Don't Know	2 (14.3%)	1 (20.0%)	1 (14.3%)	5 (23.8%)
Total	**14 (100%)**	**5 (100%)**	**7 (100%)**	**21 (100%)**

Source: REIT Survey – Opinion Survey, 2016, DBEDT

APPENDIX B: LIST OF REITS WITH PROPERTY IN HAWAII

(For the year ended December 31, 2014)

	Category	Combined: SEC+ Costar databases	Ticker	Exchange traded on
	Multiple lines			
1	storage/land/industrial	**SELECT INCOME REIT**	SIR	NYSE
2	storage/land/industrial	**EQUITY COMMONWEALTH**	EQC	NYSE
3	hotel/residential/retail	**ISTAR FINANCIAL INC.**	STAR	NYSE
4	office/residential	**DOUGLAS EMMETT, INC.**	DEI	NYSE
	Specialty			
5	Entertainment - water park	**CNL LIFESTYLE PROPERTIES, Inc.**	NNN	NYSE
6	Storage	**CORPORATE PROPERTY ASSOCIATES 17 – GLOBAL INC.**	non-traded	
7	Storage	**CORPORATE PROPERTY ASSOCIATES 18 – GLOBAL INC.**	non-traded	
8	Storage	**PUBLIC STORAGE**	PSA	NYSE
9	Storage	**EXTRA SPACE STORAGE, INC.**	EXR	NYSE
10	Storage	**W.P. CAREY, INC.**	WPC	NYSE
11	Golf Course	**NEWCASTLE INVESTMENT CORP.**	NCT	NYSE
	Office			
12		**PACIFIC OFFICE PROPERTIES TRUST, INC.**	PCFO	OTCQB Marketplace
13		**ANGELO, GORDON & CO.**	private	
14		**NORTHSTAR ASSET MANAGEMENT GROUP INC.**	NSAM	NYSE
	Health Care Facilities			
15		**SENIOR HOUSING PROPERTIES TRUST**	SNH	NYSE
16		**HEALTHCARE REALTY TRUST INCORPORATED**	HR	NYSE
17		**HEALTHCARE TRUST OF AMERICA, INC**	HTA	NYSE
	Hotel			
18		**XENIA HOTELS & RESORTS**	XHR	NYSE
19		**BEHRINGER HARVARD OPPORTUNITY REIT II, INC.**	non-traded	
20		**HOST HOTELS & RESORTS, L.P.**	HST	NYSE
21		**SUNSTONE HOTEL PARTNERSHIP, LLC**	SHO	NYSE
22		**HOSPITALITY PROPERTIES TRUST**	HPT	NYSE
23		**RLJ LODGING TRUST**	RLJ	NYSE
24		**STARWOOD PROPERTY TRUST, INC.**	STWD	NYSE

	Retail			
25		**GENERAL GROWTH PROPERTIES**	GGP	NYSE
26		**HOWARD HUGHES CORP.**	HHC	NYSE
27		**TAUBMAN CENTERS, INC.**	TCO	NYSE
28		**SIMON PROPERTY GROUP**	SPG	NYSE
29		**LEXINGTON REALTY TRUST**	LXP	NYSE
30		**AMERICAN ASSETS TRUST, INC.**	AAT	NYSE
31		**AMERICAN REALTY CAPITAL PROPERTIES, INC.** *(VEREIT - AS OF JULY 2015*)	ARCP	NYSE
32		**WP GLIMCHER, INC. (***A PART OF WASHINGTON PRIME GROUP - 2014)*	WPG	NYSE
33		**GETTY REALTY CORP.**	GTY	NYSE
34		**TORCHLIGHT INVESTORS/DOF IV REIT HOLDINGS LLC**	private	
	Mortgage			
35		**WINTHROP REALTY TRUST**	FUR	NYSE
36		**OWENS REALTY MORTAGE, INC**	ORM	NYSE
37		**NORTHSTAR REALTY FINANCE CORP.**	NRF	NYSE
38		**APOLLO COMMERCIAL REAL ESTATE FINANCE, INC.**	ARI	NYSE
39		**BLACKSTONE MORTGAGE TRUST**	BXMT	NYSE
	OTHER			
40	University Dormitory	**AMERICAN CAMPUS COMMUNITIES**	ACC	NYSE

Sources: US SEC; Costar

APPENDIX C: ACT 239

THE SENATE
TWENTY-EIGHTH LEGISLATURE, 2015
STATE OF HAWAII

S.B. NO. 118 S.D. 1 H.D. 2 C.D. 1

A BILL FOR AN ACT

RELATING TO REAL ESTATE INVESTMENT TRUSTS.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

SECTION 1. (a) The department of business, economic development, and tourism, with the assistance of the department of taxation, shall study the impact of real estate investment trusts in Hawaii and the possible effect of repealing the dividends paid deduction for real estate investment trusts. The study shall address the following:

(1) The total number of real estate investment trusts that operate in Hawaii;

(2) Of that total in paragraph (1), the number that are Hawaii-based;

(3) The number of Hawaii taxpayers who are investors in real estate investment trusts that operate in Hawaii;

(4) The number of Hawaii taxpayers who are investors in Hawaii-based real estate investment trusts that operate in Hawaii;

(5) A breakdown of Hawaii taxpayers who are investors in Hawaii-based real estate investment trusts that operate in Hawaii, by filing status and income;

(6) The direct and indirect impacts of real estate investment trusts on the Hawaii economy, especially in real estate development and operation;

(7) A comprehensive examination of captive real estate investment trusts for companies operating in Hawaii;

(8) An examination of the argument that real estate investment trusts provide opportunities for small investors to pool funds with others and invest in real estate developments, similar to investments through mutual funds invested in company stocks;

(9) An examination of the possible transfer pricing if the dividend paid income tax deduction for real estate investment trusts is repealed;

(10) An examination of the equity and efficiency of the dividends paid income tax deduction for real estate investment trusts;

(11) The projected tax revenue impact to the State if the dividends paid income tax deduction for real estate investment trusts is repealed;

(12) The impact on the real estate development market and capacity if the dividends paid income tax deduction for real estate investment trusts is repealed; and

(13) The impact on the economy of the State if the dividends paid income tax deduction for real estate investment trusts is repealed.

(b) The department of business, economic development, and tourism shall submit its findings and recommendations, including any proposed legislation, to the legislature not later than twenty days prior to the convening of the regular session of 2016.

SECTION 2. There is appropriated out of the general revenues of the State of Hawaii the sum of $100,000 or so much thereof as may be necessary for fiscal year 2015-2016 for the study on real estate investment trusts required under section 1 of this Act.

The sum appropriated shall be expended by the department of business, economic development, and tourism for the purposes of this Act.

SECTION 3. This Act shall take effect upon approval; provided that section 2 shall take effect on July 1, 2015.

S.B. NO. 118
S.D. 1
H.D. 2
C.D. 1

Report Title:
Real Estate Investment Trusts; Dividends Paid Deduction; Income Tax; DBEDT Study; Appropriation

Description:
Requires, and appropriates funds for, DBEDT, with the assistance of DOTAX, to study the impact of real estate investment trusts in Hawaii. (CD1)

The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.

SB118 CD1 LRB 15-2641.doc

APPENDIX D: SURVEY METHODOLOGY AND RESULTSREIT RESIDENTIAL SURVEYMETHOD

Instrument

The REIT Residential Survey was designed to evaluate the extent to which Hawaii residents invest in REITs. The survey instrument was comprised of a total of 12 items. The first item was a screener that asked respondents to confirm that they were residents of Hawaii at the time of fielding. Any person indicating that they were not a resident of Hawaii at the time of fielding was disqualified from inclusion in the final sample.

The second item asked respondents if they had any type of financial investments. A respondent's participation was considered complete if s/he answered this question in the negative.

The third and fourth questions asked respondents who indicated that they had any type of financial investment whether any of those investments in were either direct or indirect investments in REITs. Respondents who answered both of these questions in the negative were also counted as complete surveys.

Those respondents who indicated that they had either direct or indirect investments in REITs completed the survey by providing information to the best of their knowledge about the REIT, the size of their investment, the size of their dividends from their investment in the REIT, and some income and tax related questions.

Sampling and Fielding Procedures

A total of 2,070 qualified respondents completed the survey. A qualified respondent was anyone who was provided an opportunity to complete the survey and who indicated that they were a resident of the State of Hawaii at the time of fielding.

The sample was fielded by two methods, both of which were designed to provide reasonable representativeness of the overall population of the State of Hawaii. The first fielding method was conducted by postal mail distribution to a simple random sample of 6,000 local residential postal addresses. The addresses were drawn proportional to the population of the State by County.

Envelopes containing the two-page survey, a cover letter signed by the head of the Department of Economic Development & Tourism that explained the nature of the study, and a postage-paid return envelope were sent to selected respondents via the United States Postal Service. Completed surveys were also returned to SMS's offices by USPS.

Upon return, completed surveys were scanned by experienced staff, and all hand-written responses were verified to ensure accurate scanning of hand-written dollar amounts.

The second fielding method was via internet panel. A panel is a company that distributes electronic surveys to a pool of volunteers. Since the percentage of the residents that responded to the mail survey that had REIT investments was fairly small, it was difficult to get a robust sample of residents that had REIT investments. Therefore, the panel data was used to supplement the mail data to estimate the average amount invested in REITs by Hawaii residents with REIT investments. The survey link was prepared by SMS staff to be an exact duplicate of the mail survey including the wording and relative position of all questions. The only difference between the mail survey and the electronic survey is that the electronic survey allowed the programming of skips that would route respondents to the appropriate place in the survey based on answers to prior questions.

Table A.D.1. Fielding Details and Response Rates from Each Method of Fielding for REIT Residential Survey.

Fielding Method	Fielding Dates	Completions Acquired	Percent of Total Sample (n=2,070)	Response Rate
Internet Panel	2/17/2016-2/26/2016 & 4/12/2016-4/14/2016	1,220	58.9%	10% (est.)[16]
Postal Mail	3/14/2016-04/15/2016	850	41.1%	15.1%[17]

Data Quality Assurance

A member of SMS' project management staff was responsible for managing data quality assurance. Online data was evaluated following a so-called soft launch of the survey to ensure that the data were collecting properly and that skip logic programmed into the survey was working as expected. Once fielding was complete, SMS staff downloaded the data, saved the data in dated files, and merged data from the two waves of fielding into a single file.

Upon the completion of scanning of all completed surveys returned by mail, SMS staff examined the scanned data ensuring that all cases had an intact unique identifier and a batch number used for looking up a specific paper copy (or electronic image thereof). Additionally, any test, duplicate, or unqualified responses (non-residents) were removed from the final dataset.

Finally, the data from the panel waves were merged together with the scanned data using a single set of variable names and descriptors.

The final data set was delivered to DBEDT by SMS on 04/18/2016.

[16] Internet panel companies provide estimates of response rates but do not provide the total number of surveys links that we were distributed during the fielding period.
[17] Is the response rate out of 6,000 mailed surveys less 385 surveys that were returned by USPS as undeliverable.

Survey Instrument

CONFIDENTIAL RESIDENTIAL SURVEY

Aloha,

Thank you for completing this survey. After you finish the survey, please mail it to SMS in the pre-paid envelope provided.

1. Are you a resident of <u>Hawai'i</u>?

Yes ....O
No ***(TERMINATE)***..................O

2. Did you have any investments such as retirement plans, stocks, bonds, or mutual funds in 2014?

Yes ....O
No ***(STOP HERE AND SEND BACK THE SURVEY)*** ...O
Don't know..................O

As you may know, a Real Estate Investment Trust (REIT) is a company that owns real estate and is required to pay at least 90% of its corporate income to shareholders as dividends. <u>Hawai'i</u> REITs own properties including shopping centers, hotels, and other commercial and residential real estate.

3. To the best of your knowledge, did you have direct investments in a REIT company in 2014?

Yes ....O
No ....O
Don't know..................O

4. To the best of your knowledge, did you have any indirect investments in REIT companies, through mutual funds, exchange traded funds or other investments in 2014?

Yes ....O
No ....O
Don't know..................O

If answered **YES** to questions **<u>3 OR 4</u>**, please continue to the end of the survey.
Otherwise, please stop here and **<u>SEND BACK THE SURVEY</u>**.

MAHALO FOR YOUR PARTICIPATION!

<u>To the best of your knowledge:</u>

5. Did the REIT companies where you have investments own property <u>in Hawai'i</u> in 2014?

Yes..................O
No ....O
Don't know..................O

6. Are these REIT companies <u>headquartered in Hawai'i</u>?

Yes..................O
No ....O
Don't know..................O

7. What was the total amount you had invested in REIT companies in 2014?

$ |___|,|___|___|___|,|___|___|___|

Don't know..................O

8. **What percentage of your 2014 REIT investments were invested in Hawai'i real estate?**

|___|___|___| %

Don't know .... O

9. **What was the amount of dividends you received from your REIT investments in 2014?**

$ |___|,|___|___|___|,|___|___|___|

Don't know .... O

10. **What was the income of your household in 2014?**

Less than $30,000 .... O
$30,001 to $40,000 .... O
$40,001 to $50,000 .... O
$50,001 to $75,000 .... O
$75,001 to $100,000 .... O
$100,001 to $150,000 .... O
$150,001 to $200,000 .... O
$200,001 to $300,000 .... O
$300,001 or higher .... O
Unsure .... O
Refused .... O

11. **Did you file a Hawai'i Tax return in 2014?**

Yes .... O
No .... O
(THANK YOU AND PLEASE SEND BACK THE SURVEY)

12. **In 2014, under what classification did you file your taxes?**

Single .... O
Jointly .... O
Married, filing separate .... O
Head of household .... O
Qualified widower .... O

MAHALO FOR YOUR PARTICIPATION!

REIT STUDY – PHASE II

FINANCIAL ADVISOR SURVEY

METHOD

Phase Background and Purpose

As part of the multi-phase REIT study conducted by DBEDT, financial advisors and other investment specialists were surveyed regarding the extent to which residents of Hawaii invested in REITs.

This was done in the following three steps:

1. Instrument development
2. Initial contact of 100% of a list of financial advisors assembled by DBEDT
3. Fielding of the survey instrument

Step 1: Instrument Development

The REIT Financial Advisor survey was intended to compliment the REIT Residential Survey by asking financial advisors to estimate how much Hawaii residents invest in REITs. The questionnaire was developed by SMS in collaboration with the REIT study project team at DBEDT.

Similar in content to the residential survey, the financial advisor survey provided respondents with six items. The first two items asked financial advisors to estimate the proportion of Hawaii households with direct and indirect investments in REITs.

Items 3 and 4 asked financial advisors to consider just the Hawaii households that have REIT investments. Question 3 asked for an estimate of the percentage of households that are invested in REITs that own property in Hawaii. Question 4 asked for an estimate of the percentage of households with investments in REITs that are headquartered in Hawaii.

Items 5 and 6 asked for dollar value estimates related to REIT investments. Item five asked for an estimate of the average dollar amount per household invested in REITs. Item 6 asked for an estimate of the average amount received in dividends by households with REITs.

There were no skips in the survey so financial advisors were expected to answer all six questions. All questions were accompanied by an option for a respondent to indicate "Don't Know." The inclusion of the "Don't Know" answer option was designed to decrease non-response resulting from a lack of knowledge about the questions.

Step 2: Initial Contact of Financial Advisor List Assembled by DBEDT

DBEDT assembled a list of financial advisors and financial advisement firms that would become the basis of the sample of the study. The list of businesses was compiled using the EMSI database (NAICS codes: 523930, 523920, and 525990). This list will be referred to hereafter as the FA list, contained contact information for 383 individuals or companies that were acquired based on the NAICS codes.

DBEDT delivered an Excel file containing the list to SMS. The file contained the name of the firm, SMS reviewed the list and identified cases that were duplicated either on contact name or phone number. SMS staff also examined the list for missing phone numbers and attempted to obtain a valid phone number for any missing case by reverse phone number search using available information for each record.

The scrubbed list was uploaded into a piece of software that allows for computer-assisted telephone interviewing (CATI). CATI maintains a detailed call history for each number including dates, times, durations, and outcomes of phone calls made to each phone number in the sample. When an interviewer was able to speak to a person as the result of a dial, they read a brief script approved by DBEDT that provided a brief description of the nature and purpose of the study. For those respondents who consented to participate, interviewers confirmed the contact name and address for each respondent so that the survey could be mailed.

Each unique phone number[18] was dialed a minimum of once and a maximum of 3 times unless the respondent requested a callback on the third attempt then the maximum attempts went to 4. Attempts were terminated on a number when the contact individual was reached and replied to a request to participate in the study, the number was determined to be a non-working telephone number, the number did not belong to a financial advisor, or the number was dialed 3 times without contacting the respondent.

Calls were conducted between 3/28/2016 and 4/5/2016. Upon completion of the calls, SMS appended the complete call history for each phone number to the respondent records provided in the FA list, and sent the completed list back to DBEDT on 4/5/2016 along with a summary of call outcomes. Table A.D.2 presents the call outcome summary for the FA list.

Step 3: Fielding by Mail

Based on the call outcomes, 145 surveys were mailed to financial advisors. Among the financial advisors who were contacted, 58 consented to participate in the survey. Additionally, 87 financial advisors with whom SMS was unable to make contact after repeated call attempts were also included in the final sample. Each of the 145 respondents was sent a survey accompanied by a DBEDT-approved cover letter explaining the nature of the research and a postage-paid return envelope addressed to SMS to send the survey back for processing. The initial mailing to financial advisors was sent on 4/7/2016.

On 4/20/2016, any financial advisor from whom SMS did not receive a survey received a follow-up phone call. Calls were made to 123 financial advisors. Follow-up calls served to confirm whether each financial advisor received the survey, answer any questions about the research, and remind respondents to send back the surveys. Following the phone calls and the removal of anyone who declined to participate in the study from the mailing list, 114 surveys were sent in a second round to replace lost, damaged, or destroyed surveys, and to furnish an

[18] The list contained 62 records the phone numbers for which duplicated a phone number belonging to a different record.

initial copy to anyone who indicated they never received the first mailing. The second mailing was sent on 4/26/2016.

As a result of the first and second mailings, SMS received a total of 45 completed financial advisor surveys resulting in a response rate of 24.1% based on the 145 financial advisors who received surveys. Expected response rate for a mailed survey is approximately 10%, so this survey performed better than average, likely as a result of the preliminary and follow-up phone calls. Table A.D.3 summarizes the response rate for each round of mail and the overall study response rate.

Upon arrival at SMS offices, the surveys were opened, tagged with an arrival date, and keypunched into an excel file by trained data entry staff. The final excel file was converted into an SPSS file, variable and value labels were applied, and the final excel file was sent to DBEDT on 5/3/2016 for review and comment.

Table A.D.2: Call Outcomes, Final Sample

Call Outcomes	Records with Each Outcome	Potential Mail Recipients	Invalid/ Duplicate Addresses	Final Sample
Unavailable or Duplicate Phone Number	62	0	--	--
Refusal to Participate	33	0	--	--
Listed Contact Not at Number	79	0	--	--
Invalid or Non-Working Number	26	0	--	--
Valid Number, No Contact with Listed FA	125	125	38	87
Consent to Participate	58	58	0	58
Total Records	**383**	**183**	**38**	**145**

Table A.D.3: Study Response Rate

Mailing	Surveys Sent	Surveys Received	Response Rate
Round 1 – 4/7/2016	145	32	22.1%
Round 2 (resend) – 4/26/2016	114	13	11.4%
Total	**145**	**45**	**31.0%**

Survey Instrument

REIT INVESTMENT FINANCIAL COMPANIES

We are asking for your expert opinion. Your input, plus input from other experts in the field will allow the Department of Business, Economic Development & Tourism (DBEDT) to estimate the Real Estate Investment Trust (REIT) market in Hawai'i.

In your expert opinion:

1. **What percentage of Hawai'i households would you estimate invested directly in any Real Estate Investment Trusts in 2014?**

   |___|___|___| %

   Don't know .... O

2. **What percentage of Hawai'i households would you estimate invested indirectly in any Real Estate Investments Trusts through mutual funds, exchange traded funds or other investments in 2014?**

   |___|___|___| %

   Don't know .... O

3. **What percentage of Hawai'i households would you estimate had investments in REITs that owned property in Hawai'i in 2014?**

   |___|___|___| %

   Don't know .... O

4. **What percentage of Hawai'i households would you estimate had investments in 2014 in REITs that were headquartered in Hawai'i?**

   |___|___|___| %

   Don't know .... O

5. **What would you estimate was the average amount invested in REITs per Hawai'i households that had such investments in 2014?**

   $ |___|,|___|___|___|,|___|___|___|

   Don't know .... O

6. **What was the average amount of REIT dividends received per Hawai'i household that had such investments in 2014?**

   $ |___|,|___|___|___|,|___|___|___|

   Don't know .... O

Thank you for your participation.

REIT Investment Financial Companies — Page 1
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REIT STUDY – PHASE II

SURVEY OF REAL ESTATE INVESTMENT TRUSTS

METHOD

Phase Background and Purpose

As part of the multi-phase REIT study conducted by DBEDT, an attempt was made to survey companies operating as Real Estate Investment Trusts. The survey was designed to ascertain the volume and value of the REITs' real estate holdings in Hawaii.

This phase was executed in the following four steps:

1. Instrument development
2. Identification of REITs from a list of real-estate related companies assembled by DBEDT
3. Contact of 100% of identified REITs by phone
4. Fielding of the survey instrument

Step 1: Instrument Development

The objective of the survey of REITs was to estimate economic impact of REITs in Hawaii. The survey was designed to elicit information directly from REITs regarding the number and value of REIT-held properties in Hawaii in order to estimate economic impact and the extent to which their shareholders are residents of Hawaii. The questionnaire was developed by SMS in collaboration with the REIT study project team at DBEDT.

The survey was comprised of 10 items, the first of which asked each company to confirm that they were operating as a REIT in 2014. Any company indicating that they were not a REIT would have been excluded from the dataset.

Following the screener question, three items asked for shareholder estimates from 2014. Item 1 asked for an estimate of the REITs total shareholders. Item 2 asked for the number of shareholders who were residents of Hawaii. Item 3 asked for the percentage of total outstanding shares that Hawaii residents controlled.

Items 5 thru 7 asked REITs to report on the fair market value of their total property holdings (Item 5), the fair market value of their properties in Hawaii (Item 6), and the amount invested in 2014 in alterations and improvements to properties in Hawaii (Item 7).

Items 8 and 9 asked REITs to provide information about their companies. Item 8 asked REITs to report whether they were captive or non-captive. Item 9 asked about the real estate categories into which REITs fell.

The last item on the survey asked REITs to report the total amount of dividend income generated from their Hawaii properties in 2014.

Step 2: Identification of REITs from List of Real Estate-Related Businesses in Hawaii

In order to acquire an adequate sample of REITs with investors or property holdings in Hawaii, DBEDT provided two lists of companies in real estate-related business to SMS. The first list was acquired from the EMSI database based on real estate-related NAICS codes (531110, 531120, 531130, and 531190). The list contained 839 records of real estate-related business operating in Hawaii. The list provided the name, phone number, and address for each company. SMS called 100% of the valid, unique numbers on the list in order to identify which of the companies, if any, were operating as REITs. The list of business and a DBEDT-approved script were uploaded to software used in computer-assisted interviewing (CATI). Trained interviewers dialed each unique phone number in an attempt to speak with someone at each business who could confirm whether or not each company was a REIT. Companies that identified themselves as REITs were asked if they were willing to participate in a study about REITs and confirmed correct contact information to which a survey could be mailed.

Calls were made to real estate business between 2/19/2016 and 3/9/2016. A minimum of 1 and a maximum of 4 attempts were made on each number. Dials were terminated on a number when a person was reached and they identified whether the company was a REIT, a number was determined to be invalid or out of service, after three attempts when no contact was made with a person. A number would be dialed a fourth time if a person was reached on the third attempt and the person requested a call back.

Upon the completion of calls, the entire call history for each record was appended to the original list of all real estate business and returned to DBEDT along with a summary of the outcomes of all calls. In all, there were 803 unique, valid phone numbers in the list. Of those, 486 numbers resulted in contact with a person who could confirm the status of the company as a REIT. Of those, 4 unique REITs were identified. Table A.D.4 below presents the summary of the call outcomes for the real estate companies.

Table A.D.4. Call Outcomes for Real Estate-Related Businesses

Call Outcomes	Records with Each Outcome	REITs Consenting to Participate
Unavailable or Duplicate Phone Number	36	--
Refusal to Participate	1	--
Individual Privy to Company REIT Status Unavailable	6	--
Invalid or Non-Working Number	68	--
Valid Number, No Contact Made with Person	242	--
Completed Screener Interview	486	4
Total Records	**839**	**4**

Step 3: Pre-Notification of Known REITs

The second list provided by DBEDT to SMS contained the names and addresses of 40 companies known to be operating as REITs and owning property as REIT in Hawaii. Among the 40 listed companies, 5 companies shared a parent company and/or contact information with at least one other company on the list and were removed from the final sample as duplicates. The remaining 35 companies were all contacted by management-level staff at SMS to pre-notify companies that a survey would be coming in the mail and to confirm contact information. Calls to REITs occurred between 4/8/2016 and 4/15/2016. These calls resulted in 28 companies consenting to participate in the study.

Step 4: Fielding by Mail

Between 4/11/2016 and 4/16/2016, 32 surveys were mailed to REITs - 28 were sent to the known REITs who consented to participate and 4 were sent to the Hawaii REITs identified in the calls to the real estate businesses.

As of 4/25/2016 SMS received no surveys back from the initial round of mailing. To motivate REITs to respond to the survey, SMS management-level staff made follow-up calls to all REITs who received the survey. Follow-up calls were intended to confirm receipt of the mailed surveys, remind REITs to participate, and offer to re-send surveys. During the follow-up calls, several REITs rescinded their consent to participate due to the sensitive nature of the information being collected or on advice of their legal departments. Any REIT that did not expressly decline to participate and any REIT with whom no contact was made during the first round of pre-notification calls were sent the survey in a second mailing of 40 surveys on 4/26/2016.

As of 5/13/2016, only one REIT sent back a survey which contained no data and that was accompanied by a by-question explanation for why they did not provide data. As the one survey that was returned contained no useable data, the effective response rate for the survey was 0%. Table A.D.5 below summarizes the number of surveys distributed in each round of mailing and presents the response rates for each round of mail and the overall study.

SMS asserted its best efforts to obtain data from REITs on this survey. Pre-notification calls and follow-up mailings are tactics typically employed to increase response rates for mailed surveys and are generally successful. Contrary to history, neither a pre-notification nor follow-up made any impact on the response rate. As such, SMS has exhausted its ability to motivate participation from survey recipients.

Table A.D.5: Study Response Rate

Mailing	Surveys Sent	Useable Surveys Received[19]	Response Rate
Round 1 – 4/11/2016-4/16/2016	35	0	0.0%
Round 2 – (resend) 4/26/2016	40	0	0.0%
Total REITs Surveyed	**40**	**0**	**0.0%**

[19] One survey was mailed back by a respondent but contained no useable data.

Survey Instrument

REIT COMPANY CONFIDENTIAL SURVEY

Thank you for participating in this confidential survey – all responses will be aggregated and no company name or respondent name will be associated with any of the data.

1. **First, we would like to confirm that your company was a Real Estate Investment Trust in 2014.**

   Yes .... O
   No .... O

2. **What was your company's total number of shareholders (institutional and individual) in 2014?**

   |___|___|,|___|___|___| estimated number of shareholders

   Don't know .... O

3. **Of the total number indicated in question 2, how many shareholders were Hawaii residents in 2014?**

   |___|___|,|___|___|___| estimated number of shareholders

   Don't know .... O

4. **What percentage of total outstanding shares did the Hawai'i shareholders control in 2014?**

   |___|___|___| % Total

   Don't know .... O

5. **What was the total property value owned by your company in 2014 (fair market value)?**

   $ |___|___|___|,|___|___|___|,|___|___|___|,|___|___|___|

   Don't know .... O

6. **What was the total value of Hawai'i property owned by your company in 2014 (fair market value)?**

   $ |___|___|___|,|___|___|___|,|___|___|___|,|___|___|___|

   Don't know .... O

7. **What was the amount invested in additions and alterations (property improvements) for Hawai'i property in 2014?**

   $ |___|___|___|,|___|___|___|,|___|___|___|,|___|___|___|

   Don't know .... O

8. **Is your REIT a <u>captive</u> REIT?** ***(CHECK ONLY ONE):***

   Yes .... O
   No .... O

9. **Please identify the real estate investment categories of your REIT in 2014.**

   Retail .... O
   Hospitality/Hotels .... O
   Industrial/Warehouse/Land .... O
   Residential/Apartments .... O
   Healthcare/Eldercare Facilities .... O
   Storage .... O
   Mortgage .... O
   Student Housing/Dormitories .... O
   Entertainment Complexes/Water parks .... O
   Other (specify): ______________________ ..... O

10. **What was the estimated amount of dividend income generated from Hawai'i property in 2014?**

    $ |___|___|___|,|___|___|___|,|___|___|___|,|___|___|___|

REIT STUDY – PHASE II

REIT INDUSTRY EXPERTS AND STAKEHOLERS SURVEY

METHOD

Phase Background and Purpose

As part of the multi-phase REIT study conducted by DBEDT, a group of persons identified as industry experts and stakeholders were surveyed in a 2-Wave Delphi-style survey regarding their opinions about the impact of REITs on the Hawaii real estate market and economy in general.

This phase was executed in five steps including:

1. Identification of industry experts and stakeholders by DBEDT
2. Development of the Wave 1 instrument
3. Fielding of Wave 1
4. Development of a Wave 2 instrument based on summarized responses to the Wave 1 instrument
5. Fielding of Wave 2

Step 1: Identification of Industry Experts and Stakeholders

Experts and stakeholders were identified from two sources. First, persons who testified before the Hawaii State Legislature on the matter of REITs and the Dividend Paid Deduction (DPD) were compiled into a list by DBEDT and delivered to SMS. Among the information provided by DBEDT for each of these persons were names, contact information including mailing addresses, and an indication of the capacity in which each person testified (e.g., concerned resident, business owner, real estate investor, etc.). Upon receipt of the list of stakeholders, SMS fielding staff attempted to find missing information from any incomplete address in order to maximize the success of mailing efforts.

The second source of expert information was drawn from the list of REITs identified in the REIT phase (Phase 3) of the study. REITs were regarded as subject matter experts whose opinions were assertively pursued in order to ensure an appropriately balanced collection of stakeholder opinions regarding the impact of REITs in Hawaii.

Step 2: Development of Wave 1 Instrument

REIT industry experts and stakeholders were surveyed via a Delphi-type survey method. A Delphi method involves the iterative surveying of a group of individuals regarded as experts in some subject matter. The revised survey instrument fielded in each iteration is meant to reflect a summary of responses from experts in the preceding iteration or wave. The supposition underlying a Delphi survey is that a collective of experts whose opinions are informed by their peers will arrive at a consensus opinion about some event, idea, policy, or practice.

The objective of the Wave 1 instrument was to obtain opinions from stakeholders regarding the impact of the existence of the DPD and the likely impact of its repeal. The instrument was developed by SMS in collaboration with the REIT project team at DBEDT.

Item 1 asked stakeholders whether REITs provided a good opportunity for small investors to invest in large real estate developments.

Items 2 thru 7 asked for opinions about the DPD including whether Hawaii would lose revenue through transfer pricing if the DPD were repealed (Item 2), the magnitude of decrease in Hawaii real estate investment if the DPD were repealed (item 3), whether the DPD is equitable for Hawaii as a state (Item 4), and whether the DPD is an efficient tool for capital investment allocation (item 6). Items 5 and 7 were open-ended questions that sought to solicit an explanation for the responses provided in items 4 and 6 respectively.

Item 8 asked respondents to classify themselves into one of 10 categories that best described who they were as an indication of the type of stakeholder they were.

There were no skips in the survey so stakeholders were expected to answer all eight questions. With the exception of the open-ended items and the self-classification question, all items provided stakeholders with an option of "Don't Know" or "No Opinion" to reduce by-item non-response because a lack of knowledge or attitude on any question.

Step 3: Fielding of Wave 1 Instrument

The Wave 1 instrument was fielded by postal mail using the addresses in the file prepared in Step 1. The initial mailing was distributed on 3/22/2016 to a total of 112 stakeholders who testified before the legislature. In order to maximize participation rates, a second mailing of the Wave 1 survey went out to all stakeholders from whom SMS had not received a survey by the time the second mailing went out on 4/11/2016. A total of 93 surveys were mailed in the second mailing. On 4/19/2016, SMS made reminder calls to survey recipients from whom surveys had not been received to that point.

SMS received a total of 45 responses to the Wave 1 stakeholder survey which represents a 40.1% response rate. SMS delivered the first draft of stakeholder dataset to DBEDT via email on 5/3/2016.

Step 4: Development of Wave 2 Instrument

Following examination of Wave 1 data, DBEDT determined that the best objective for the Wave 2 survey was to determine whether stakeholders and experts agreed with the opinions provided by respondents in the open-ended responses to the Wave 1 survey. As such, SMS and DBEDT collaboratively coded the responses to the open-ended questions in the Wave 1 survey. Coding resulted in the identification of seven frequently occurring themes across the two open ended questions on the Wave 1 survey.

The Wave 2 survey was comprised of 8 items, the first seven of which asked respondents to indicate whether they agreed with various beliefs about REITs and the DPD that emerged from the open-ended comments. The last item was carried over from the Wave 1 survey and asked respondents to identify what type of stakeholder they are. The full survey instrument is contained in the appendix to this document.

In addition to the Wave 2 survey that was developed for distribution to all of the stakeholders who testified before the legislature on the matter of REITs, a second version of the Wave 2 survey was also constructed. In an earlier phase of work on this project, SMS attempted to survey companies that were identified as operating as REITs (see Survey of REITs Method report for details). That phase of data collection was suspended after SMS received no completed surveys from REITs. Many of the REITs that SMS contacted cited recommendation from their legal counsel or risk mitigation departments not to participate due to the nature of the questions. However, in order to ensure adequate representation of REITs in the data for this study, a second attempt was made to survey them. Rather than asking questions about the business, the Wave 2 survey was adapted for a contact individual at each REIT in order to solicit opinions about REITs and the DPD.

The Wave 2 survey for the REITs included all of the questions from the Wave 1 survey with the exception of the open-ended questions and all of the questions from the Wave 2 survey. In total, the REIT version of the Wave 2 survey comprised 12 items.

Step 5: Fielding of Wave 2 Instrument

Following final approval of the survey instrument and associated cover letter for each version of the Wave 2 survey by DBEDT, SMS staff mailed a total of 152 Wave 2 surveys – 112 were distributed to the mailing list from Wave 1 and 40 were mailed to REITs. All recipients of the Wave 1 survey were also mailed the Wave 2 survey regardless of whether they returned the Wave 1 instrument. Mailing was completed on 5/23/2016. Follow up reminder calls were made to all Wave 2 recipients who had not yet returned surveys between 6/6/2016 and 6/14/2016.

Data Handling

Upon arrival at SMS offices, the surveys were opened, tagged with an arrival date, and keypunched into a designated excel file by trained data entry staff. Upon close of fielding on 6/15/2016, 23 surveys of 112 (20.5%) were returned from persons who testified before the legislature and 2 surveys of 40 (5.0%) were returned from REITs.

For the REIT surveys, the data from the Wave 1 items were separated from data from the Wave 2 items. REIT data from each wave was appended to the appropriate dataset for the other stakeholders. The result was 2 datasets – one for Wave 1 and the other for Wave 2, each one containing available data from both REITs and other stakeholders.

Following the merging of data and the finalization of the Wave 1 and Wave 2 datasets, variable and value labels were applied to the dataset, and the final SPSS file was sent to DBEDT on 6/17/2016 for review and comment.

Table A.D.6: Expert Stakeholder Response Rate by Wave and Recipients

Mailing	Surveys Sent	Surveys Received	Response Rate
Wave 1			
Stakeholders	112	45	40.1%
REITs[20]	40	2	5.0%
Total	**152**	**47**	**30.9%**
Wave 2			
Stakeholders	112	23	20.5%
REITs	40	2	5.0%
Total	**152**	**25**	**16.4%**

[20] REIT data for Wave 1 was collected during Wave 2.

Wave 1 Survey Instrument

REIT EXPERTS SURVEY

We are asking for your expert opinion. Your input, plus input from other experts in the field will allow the Department of Business, Economic Development & Tourism (DBEDT) to estimate the Real Estate Investment Trust (REIT) market in Hawai'i and its impact on State revenues.

In your expert opinion:

1. **Do REITs provide a good opportunity for small investors by allowing them to invest in large real estate developments – similar to mutual funds invested in stocks?**
   - Yes .... O
   - No .... O
   - No Opinion .... O

2. **Would the State of Hawai'i lose tax revenue through transfer pricing by REITs if the dividend paid deduction (DPD) is repealed?**
   - Yes .... O
   - No .... O
   - No Opinion .... O

3. **If the Dividend Paid Deduction (DPD) were repealed, what impact would that have on real estate investment in Hawai'i over 5 years? *(PLEASE SELECT ONLY ONE RESPONSE)***
   - No change .... O
   - Decrease by 0% to 5% .... O
   - Decrease by 5% to 10% .... O
   - Decrease by 10% to 20% .... O
   - Decrease by 20% to 30% .... O
   - Decrease by more than 30% .... O
   - Don't know .... O

4. **Is the REIT dividend paid deduction (DPD) equitable for the State of Hawai'i overall?**
   - Yes .... O
   - No .... O
   - Don't know .... O

5. **Why do you say that?**

   ____
   ____
   ____
   ____

6. **Is the REIT dividend paid tax deduction an efficient tool to allocate capital investment?**
   - Yes .... O
   - No .... O
   - Don't know .... O

7. **Why do you say that?**

   ____
   ____
   ____
   ____

8. **Which of the following would best describe who you are?**
   - Business Executives .... O
   - Concerned Resident .... O
   - Developer .... O
   - Financial Advisor .... O
   - Other Financial Investor .... O
   - Politician/Legislator .... O
   - Real Estate Investor (non-REIT investor) .... O
   - Real Estate Investor (REIT investor) .... O
   - Researcher .... O
   - Other (specify): ______________ . . O

Thank you for your participation!

Wave 2 Survey Instrument – Stakeholder Version

CONFIDENTIAL SURVEY – REIT INDUSTRY EXPERTS AND STAKEHOLDERS

The Hawai'i State Department of Business, Economic Development & Tourism (DBEDT) would like to know your opinion about the impact of Real Estate Investment Trusts (REITs) and the REIT Dividend Paid Deduction (DPD).

<u>This is the second wave of a survey we initially sent in early April and we are asking for your opinion again</u>. We appreciate your willingness to complete this survey within the next 7 days and return it to us in the enclosed postage-paid envelope.

Please indicate whether you agree with each of the following statements regarding REITs and/or the DPD.

1. **The Dividend Paid Deduction (DPD) results in mainland REIT investors gaining more financial benefit from Hawai'i than Hawai'i receives in return.**
   - Agree..O
   - Disagree...O

2. **REITs increase the flow of capital into Hawai'i for property investment which benefits the state.**
   - Agree..O
   - Disagree...O

3. **If the DPD were repealed, Hawai'i would still be an attractive market for real estate investors.**
   - Agree..O
   - Disagree...O

4. **Repealing the DPD would have a negative impact on Hawai'i's reputation as an investment-friendly environment.**
   - Agree..O
   - Disagree...O

5. **The DPD distorts Hawai'i property values.**
   - Agree..O
   - Disagree...O

6. **The DPD prevents Hawai'i from receiving an appropriate amount of corporate income tax benefit from REIT investments.**
   - Agree..O
   - Disagree...O

7. **REITs pay taxes including general excise tax and property tax which brings a net benefit to Hawai'i.**
   - Agree..O
   - Disagree...O

8. **Which of the following best describes you? (SELECT ONE)**
   - Concerned Resident ....O
   - Developer..O
   - Financial Advisor......................................O
   - Other Financial Investor..........................O
   - Politician/Legislator ....O
   - Real Estate Investor (REIT)....................O
   - Real Estate Investor (non-REIT)............O
   - Researcher...O
   - Other (specify ____________________..O

Thank you for your participation!

REIT Confidential Survey | Page 1
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CONFIDENTIAL EXPERT OPINION SURVEY – REAL ESTATE INVESTMENT TRUSTS

In April, you received a survey from the Hawai'i State Department of Business, Economic Development & Tourism asking you to describe some of the characteristics of your REIT.

In response to feedback from respondents, rather than asking for you to describe your company, we are now asking for your expert opinion about the economic impact of REITs in Hawai'i. Your responses to this survey will ensure that a variety of opinions are adequately represented in an assessment of the value and impact of REITs in Hawai'i's economy.

We appreciate your taking the time to complete this survey. When you're finished, please return the survey in the postage-paid envelope included in this packet.

Mahalo for your participation.

1. **Do REITs provide a good opportunity for small investors by allowing them to invest in large real estate developments – similar to mutual funds invested in stocks?**
   Yes .... O
   No .... O
   No Opinion .... O

2. **Would the State of Hawai'i lose tax revenue through transfer pricing by REITs if the dividend paid deduction (DPD) is repealed?**
   Yes .... O
   No .... O
   No Opinion .... O

3. **If the Dividend Paid Deduction (DPD) were repealed, what impact would that have on real estate investment in Hawai'i over 5 years? *(PLEASE SELECT ONLY ONE RESPONSE)***
   No change .... O
   Decrease by 0% to 5% .... O
   Decrease by 5% to 10% .... O
   Decrease by 10% to 20% .... O
   Decrease by 20% to 30% .... O
   Decrease by more than 30% .... O
   Don't know .... O

4. **Is the REIT dividend paid deduction (DPD) equitable for the State of Hawai'i overall?**
   Yes .... O
   No .... O
   Don't know .... O

5. **Is the REIT dividend paid tax deduction an efficient tool to allocate capital investment?**
   Yes .... O
   No .... O
   Don't know .... O

6. **The DPD results in mainland REIT investors gaining more financial benefit from Hawai'i than Hawai'i receives in return.**
   Agree .... O
   Disagree .... O

7. **REITs increase the flow of capital into Hawai'i for property investment which benefits the state.**
   Agree .... O
   Disagree .... O

8. **If the DPD were repealed, Hawai'i would still be an attractive market for real estate investors.**
   Agree .... O
   Disagree .... O

9. **Repealing the DPD would have a negative impact on Hawai'i's reputation as an investment-friendly environment.**
   Agree .... O
   Disagree .... O

10. **The DPD distorts Hawai'i property values.**
    Agree .... O
    Disagree .... O

11. **The DPD prevents Hawai'i from receiving an appropriate amount of corporate income tax benefit from REIT investments.**
    Agree .... O
    Disagree .... O

12. **REITs pay taxes including general excise tax and property tax which brings a net benefit to Hawai'i.**
    Agree .... O
    Disagree .... O

Thank you for your participation!

REIT Experts Survey
Page 1

May, 2016