Memo

September 13, 2021

To: **Hawaiʻi Tax Review Commission**

From: **Beth Giesting**

Re: **Proposed recommendation:**

To help the state and counties meet future obligations, the Tax Review Commission should include among its recommendations that counties should further explore opportunities to use real property taxes as a means to increase the equity and adequacy of the overall tax system, and leverage resources to meet Hawaiʻi's future challenges.

Hawaiʻi's State Constitution, according to its preamble, calls for "the right to control our destiny, to nurture the integrity of our people and culture, and to preserve the quality of life that we desire."[1] Hawai'i now faces extraordinary challenges to meet growing public obligations and help local residents and communities thrive despite growing economic stresses. This memo summarizes how real property taxes have been deployed among the counties, and how they could be better used as a means of equitable taxation to help us meet our public responsibilities.

Hawaiʻi's Public Spending, Resource Needs, and Revenue Options. Hawaiʻi has an unusually centralized State government, which bears nearly full responsibility for education, social welfare, and health care and hospitals. The authority to levy taxes is also largely reserved to the state. The most significant exception is the authority over real property taxes, which, when the State Constitution was amended in 1978, was transferred exclusively to the counties.

Regarding the concentration of public policy and spending at the state level, the first Tax Review Commission's 1984 report noted that the "degree of centralization may have been appropriate for conditions 15 or 20 years ago, but since then the counties have evolved into more populous jurisdictions with greater political sophistication. The degree of dominance held by the State is thus called into question."[2]

Almost 40 years later, responsibility for public services remains concentrated at the state level, but current and foreseeable budget priorities have increased substantially. The combined budgets for education, Medicaid and other human services, debt service, and retirement contributions grew by 80

[1] https://lrb.hawaii.gov/constitution#preamble
[2] https://files.hawaii.gov/tax/stats/trc/docs1984/1st_TRC_Report_1984.PDF

percent (in 2021 dollars) between 2004 and 2021. This limited array of obligations now accounts for 48 percent of the state's budget.

In addition to ensuring that revenue is adequate to support education, health and human services, and other current obligations, Hawaiʻi needs to address emerging capital and operating needs. A combination of state and county resources is needed to address the following:

- Capital development and improvement costs for public facilities, infrastructure, and climate change remediation. In 2019, the Hawaiʻi Executive Conference estimated state-level capital needs that amounted to $59.3 billion as follows:
    - $12.6 for public schools
    - $1 billion for public safety
    - $1.1 billion for new public facilities
    - $8.9 billion for deferred maintenance on existing public facilities
    - $5.7 billion for county water and wastewater improvements
    - $15.3 billion for preparing for natural disasters and climate change
    - $14.7 billion for transportation

- Housing infrastructure development and construction to ensure that low- to middle-income Hawai'i families have decent homes they can afford. A recent study estimates that for Maui County alone the cost to build 5,000 affordable units over the next five years will require $800 million in housing subsidies, so meeting statewide needs could amount to more than $6.5 billion.

- Public preschool for all 4-year-olds to help all kids succeed in school and life as well as to reduce expenses for families who have to pay for private care. The 2020 census estimates a total of 17,600 4 year-olds. At the cost per public school enrollee of $12,000, the budget could exceed $200 million annually.

The state's current array of revenue options has limits: The General Excise Tax is Hawaiʻi's largest revenue producer. Even though the rate is comparatively low, it is a burden for low-income families because the GET is broadly applied, including to food and other essentials.

Individual income taxes generate the second largest amount of revenue, but increasing their yield is problematic. Some of the reasons are:

- Hawaiʻi's population of seniors and retirees is growing. When it comes to income taxes, this group typically produces less taxable income not only due to reduced earnings from wages but also because Hawaiʻi doesn't tax retirement income from pensions and Social Security. Seniors claim more exemptions, too. The continuing shift in population leaves a smaller proportion of working-age people to pay taxes to support a growing state budget. In the five years between 2014 and 2018, the number of tax returns with at least one age exemption increased by 12 percent. In 2018, $4.6 billion in pension and social security benefits were exempted from Hawaiʻi income taxes.[3]

- Most of Hawaiʻi's workforce is in low-wage jobs, which means that the majority of workers pay little in income taxes. In 2018, the Department of Taxation reported that 56 percent of resident filers had an adjusted gross income of $50,000 or less and contributed only 12 percent of all income tax revenue.[4]
- Hawaiʻi's economy also produces a relatively small number of extremely wealthy residents (in 2018, only 1 percent had an AGI of $400,000 or more) and so raising the marginal rate on the top end would yield less revenue than in many other high cost states.[5]

Real Property Taxes in Hawaiʻi

The following summarizes the recent history of property tax rates in Hawaiʻi, compares residential rates here with other jurisdictions, and identifies one option being considered by the Maui County Council to leverage increased tax rates.

Hawaiʻi's historic and current real property tax rates. The 1984 TRC report notes that, because of the relatively limited responsibilities of counties, real property tax (RPT) rates declined even as revenues remained stable due to rising property values. The report included a table that noted county RPT rates from 1975 and 1984. The table below reproduces that information (but translates dollars per thousand property value to percentages) and adds more recent rates up to 2022.

Table 1. *Hawaiʻi County Real Property Tax Rates, 1975 to 2022. Rates are expressed as percentages, but may also be shown as dollars per thousand. For instance, Honolulu's 2021 rate of 0.575% may be expressed as $5.75 per $1000 of property value. The first row for each year shows the average rate for all categories of properties. The second row shows the average for just residential categories. The residential-only row does not include properties categorized as short-term and vacation rentals.*

Fiscal Year	Honolulu	Maui	Hawaiʻi	Kauaʻi	Average
2022 - All	0.575%	0.708%	0.984%	0.685%	0.645%
2022 - Res Only	0.391%	0.444%	0.975%	0.519%	0.465%
2020 - All	0.580%	0.695%	0.969%	0.684%	0.641%
2020 - Res Only	0.392%	0.456%	0.951%	0.508%	0.457%

[3] Department of Taxation Annual Income Tax Statistical Reports https://tax.hawaii.gov/stats/a5_1annual/a5_5ind_inc/
[4] Ibid
[5] Ibid

Fiscal Year	Honolulu	Maui	Hawaiʻi	Kauaʻi	Average
2015 - All	0.534%	0.651%	0.920%	0.671%	0.598%
2015 - Res Only	0.373%	0.457%	0.889%	0.490%	0.433%
2010 - All	0.505%	0.540%	0.761%	0.538%	0.541%
2010 - Res Only	0.342%	0.357%	0.715%	0.455%	0.385%
2005 - All	0.537%	0.594%	0.878%	0.609%	0.587%
2005 - Res Only	0.376%	0.481%	0.800%	0.521%	0.433%
2000 - All	0.547%	0.587%	0.819%	0.668%	0.585%
2000 - Res Only	0.390%	0.447%	0.714%	0.566%	0.429%
1995 - All	0.489%	0.553%	0.846%	0.583%	0.533%
1995 - Res Only	0.335%	0.423%	0.751%	0.511%	0.380%
1990 - All	0.729%	0.592%	0.909%	0.733%	0.728%
1990 - Res Only	0.629%	0.459%	0.879%	0.664%	0.631%
1985 - All	0.746%	0.447%	0.911%	0.755%	0.723%
1985 - Res Only	0.675%	0.446%	0.873%	0.711%	0.661%
1984 - All	0.760%	0.450%	0.919%	0.805%	0.734%
1984 - Res Only	0.705%	0.450%	0.881%	0.788%	0.685%
1983 - All	0.806%	0.450%	1.001%	0.870%	0.776%
1983 - Res Only	1.263%	0.750%	1.648%	1.439%	1.220%
1982 - All	0.914%	0.450%	1.074%	0.870%	0.853%
1982 - Res Only	1.465%	0.750%	1.790%	1.450%	1.360%
For the years below, rates are the average for all properties.					
1981	0.914%	0.388%	1.074%	0.870%	0.857%
1980	0.914%	0.545%	1.074%	0.870%	0.855%
1979	0.914%	0.718%	1.074%	0.870%	0.887%
1978	0.922%	0.750%	1.074%	0.870%	0.915%
1977	0.922%	0.750%	1.074%	0.870%	0.919%

Fiscal Year	Honolulu	Maui	Hawaiʻi	Kauaʻi	Average
1976	1.076%	0.980%	1.253%	1.015%	1.072%
1975	1.240%	1.050%	1.253%	1.015%	1.072%

Source for data from 1975-1984:
https://files.hawaii.gov/tax/stats/trc/docs1984/1st_TRC_Report_1984.PDF
Source for data from 1985 and after: https://www.realpropertyhonolulu.com/state-reports/#2017.
Methodology: total RPT revenue divided by total valuation for taxes.

The 1984 Commission concluded that "Had the [property tax] rate remained unchanged between 1983 and 1984, the counties would have had an additional $16.5 million in revenue." It appears that if the counties applied 1983 rates in 2022, the collective increase in revenue would have amounted to $465 million (in 2021 dollars), but the results would be uneven across counties: Maui County would actually collect $140 million *less* because its RPT rate has rebounded and is now nearly back to its 1979 percentage, but Honolulu would have added $556 million, Hawaiʻi County $6 million, and Kauaʻi County $43 million.

Real property tax rates and the non-owner-occupied housing market. The increase in wealth and income inequality since the Great Recession means there are more investors with an abundance of cash to spend. Hawaiʻi is an attractive target for these investors, not just because of the desirability of Hawaiʻi, but also because our limited housing inventory serves to drive prices up. Hawaiʻi's low RPT rates result in low annual expenses, and that also makes local real estate a relative bargain for investors and affluent second home purchasers.

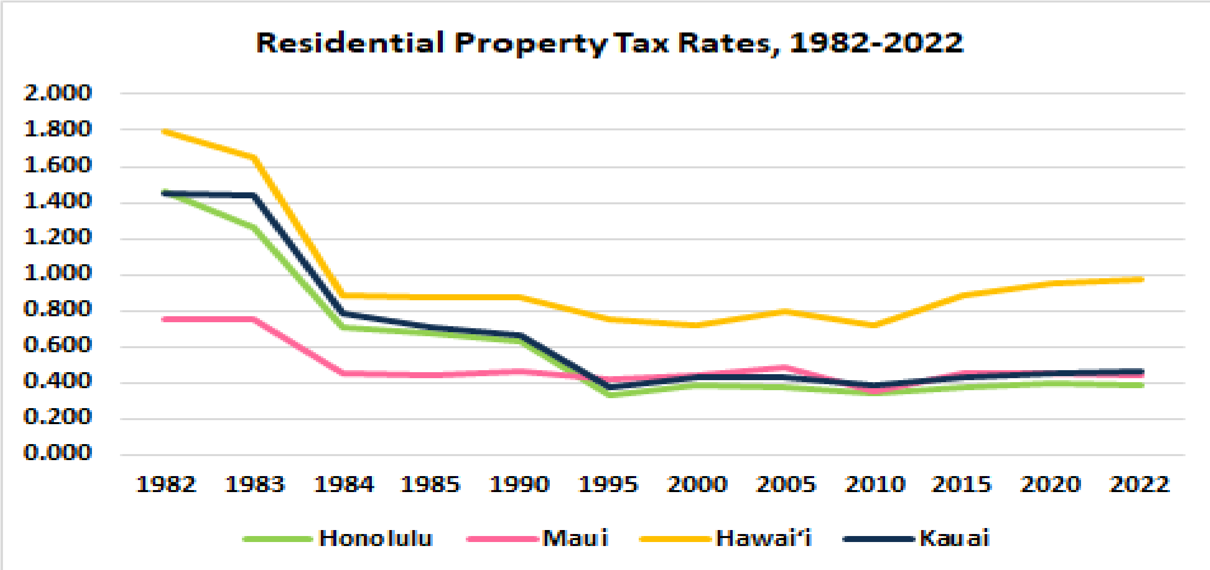
The increase in homes purchased as investments contributes to a competitive market and raises overall housing prices. Additionally, to the extent that units are purchased for vacation rentals or second homes, there is less housing available for people who live here. The *2019 Hawaiʻi Housing Planning Study* prepared for the Hawaiʻi Housing Finance & Development Corporation reported that only "48 percent of out-of-state owners rented their units while they were not using them." Although the data deserves further scrutiny, it appears that on Neighbor Islands, which use categories that indicate owner-occupancy, the percentage of units with that designation dropped from 53 percent in 2018 to 45 percent in 2020. During the same span, the number of units designated as investment and vacation properties more than doubled.

In response to the increased demand for Hawaiʻi residential real estate for investment rather than use as a primary residence, differential tax rates are now in place for all counties. In fact, all counties except Honolulu started on this path in 1995.

***Table 2**. County differential rates feature higher rates for both non-owner-occupants and for higher-priced properties, as summarized here.*

A Chronology of Hawaiʻi Residential Real Property Tax Rates	
Pre-1995	Each county has a single "improved residential" category. Rates in 1990 are .609% for **Honolulu**, .450% for **Maui**, .850% for **Hawaiʻi**, and .610% for **Kauaʻi**.
1995	All counties except Honolulu add a "homeowner" category with favorable tax rates. **Maui's** homeowner rate is .350%, **Hawaiʻi**'s is .445%, and **Kauaʻi's** is .404%. **Honolulu** drops its improved residential rate from .609% to .312% but doesn't distinguish between owner-occupied and other residential properties.
2010	**Maui** adds a timeshare rate (highest of all categories at 1.400%). Drops homeowner rate to .200%. **Hawaiʻi** adds a rate for "affordable rental" equivalent to the "homeowner" rate of .555%
2015	**Honolulu** adds "Residential A" (non-owner-occupied) at a rate of .600%. **Maui** adds "commercialized residential" (e.g., a Bed & Breakfast with the owner on-site) at a rate of .446% **Kauaʻi** adds vacation rental at a rate of .885%.
2016	**Kauaʻi** adds commercialized residential rate of .505% and "residential investor" rate of .705%
2018	**Honolulu** adds Residential A Tier 1 (property valued at up to $1 million) rate of .450% and Tier 2 (value over $1 million) rate of .900%
2019	**Maui** adds "short-term rental" rate of .928%
2021	**Honolulu** adds "Bed & Breakfast Home" rate of .650% **Maui** adds Tiers 1-3 based on valuation of property. Tier 1 is a value up to $800,000. Tier 2 is $801,000 to $1,500,000. Tier 3 is more than $1,500,000. Rates for "non-owner-occupied" by tier are .545%, .605%, and .800% Rates for "owner-occupied": .241%, .251%, and .271% Rates for "short-term rentals": 1.111%, 1.115%, 1.112% **Hawaiʻi** adds non-homestead residential Tiers 1 and 2: 1.110% (portion valued at less than $2 million) and 1.360% (portion valued at $2 million or more)

This figure shows, at a glance, how residential property rates have changed since 1982. (These residential rates pertain to the categories of residential, unimproved residential, residential A, apartment, affordable rental, homeowner or homestead, commercialized residential, and residential investor.)



Hawaiʻi Residential RPT Compared to Other Jurisdictions. According to the most recent public reports,[6] residential property tax rates in Hawaiʻi are still the lowest in the nation. Even when considering the high value of homes here, Hawaiʻi property owners pay the 20th lowest amount. The rates and real property taxes on the median value of a home in the following states are:

	Average Resident Property Tax Rate	Taxes Due on Median Value Home in State
Hawaiʻi	0.280%	$1,715
National Average	1.240% (2016)	$3,313
Average for States with Highest Rates		
New Jersey	2.249%	$8,362
Illinois	2.270%	$4,419
New Hampshire	2.180%	$5,701
Connecticut	2.140%	$5,898
Vermont	1.900%	$4,329
Rates for Selected High-Cost Housing Areas		

[6] https://wallethub.com/edu/states-with-the-highest-and-lowest-property-taxes/11585 and https://www.mortgagecalculator.org/helpful-advice/property-taxes.php

City/State/Country	Average Paid/Rate (2020)	Average Home Value (2020)
San Francisco, CA	● Owner-Occupied: $17,767 ● Non-OO: $17,850 ● Rate: 1.190%. ● $7,000 homeowner exemption	$1.5 million
Park City, UT	● Owner-Occupied: $7,040 ● Non-OO: $14,464 ● Rate: 0.550% for primary residence; higher rate for properties of more than 1 acre. ● 1.130% for secondary residence.	$1.28 million
Vail, CO	● Owner-Occupied: $6,020 ● Non-OO: $6,101 ● Seniors: $5,590 ● Rate: 0.430%. ● $20,000 homeowner exemption. Senior homeowner exemption is $100,000.	$1.42 million
Key West, FL	● Owner-Occupied: $4,690 ● Non-OO: $5,025 ● Rate: 0.670% ● $50,000 homeowner exemption	$750,000
Seattle, WA	● Owner-Occupied: $6,640 ● Non-OO: same ● Rate: 0.930%	$714,000
Aspen, CO	● Owner-Occupied: $25,488 ● Non-OO: $25,560 ● Senior: $25,128 ● Rate: 0.360% ● $20,000 homeowner exemption. $100,000 senior exemption.	$7.1 million
Vancouver, Canada	● Owner-Occupied: $2,910 ● Non-OO: $3,480 ● Investor Owner: $15,000 ● Rate: 0.290% for homeowner. 1.250% for investor owner. ● Up to $570 “grant” to offset homeowner’s tax.	$1.2 million

Counties can leverage RPT revenues. Adjusting RPT rates to capture more revenue from high-value houses and non-resident owners can produce tens of millions more dollars per year that counties can use for growing needs. But the extra revenue can be a means to leverage even more money for infrastructure needs. For example, the Maui County Council is exploring using increased property tax revenues to pay off general obligation bonds the county can use to finance housing and transitional housing services for local residents. Similar strategies are being used successfully in Los Angeles, San Francisco, and Portland, Oregon.