

# 2<sup>nd</sup> Subcommittee on Rates and Classifications Meeting (October 15, 2021)

Honolulu Hale 2<sup>nd</sup> Floor Conference Room and WebEx

Attendees: Commissioner Jack Legal, Commissioner Aki Peters, Commissioner Foo Pham

Commission Aide George White attended by request of the Commissioners.

The Subcommittee on Rates and Classifications ("Subcommittee") met to discuss issues discussed at the previous meeting of the O'ahu Real Property Tax Advisory Commission ("Commission"). Although not required, the Subcommittee provides this written report for the Commission meeting scheduled for October 22, 2021.

The topics discussed and included in this report are as listed:

1. Vacant Residential Properties and Bill 76 (2020)
2. Nomenclature of Residential/Residential A Classifications and new proposal by the Policy Subcommittee, including tiering for all residential classifications
3. Land Value Tax Study Objectives

## Vacant Residential Properties

The Subcommittee compared Bill 76 (2020) to an alternative vacant residential taxation strategy, *Empty Homes Tax Proposal*, which was submitted to the Commission for consideration. The comparison of the two strategies is summarized in the table below:

Concept	Bill 76 (2020)	<i>Empty Homes Tax Proposal</i>
Primary Action	Establishes a new tax classification (residential property could be classified exclusively as Residential, Residential A, <b>OR</b> vacant residential)	Establishes a supplemental tax classification (residential property could be classified as Residential OR Residential A, and then could also be classified as vacant residential)
Enforcement	Not mentioned	Annual property status declaration, separate from annual property tax; defines documents to verify occupancy; offers an opportunity to appeal
Defined exclusions (or "exemptions")	Occupied for more than 180 days, owner under medical care, transferred, deceased owner, under renovation, or court order	Occupied by owner for more than six months, occupied by renter(s) for more than six months, court order, deceased owner, Armed Forces duty, substandard building (limited to one year every five), under renovation (limited to one year every five), actively listed for sale (limited to one year every five), non-profit owner for

		temporary housing for non-profit mission, senior/disability/half-way housing
Administrative costs	Not mentioned	Up to 5% of empty homes tax revenues for administrative costs
Tax year	Applied to future fiscal year (because it is a tax classification)	Applied to past year

#### Recommendations:

- The Subcommittee DOES NOT recommend Bill 76 (2020).
- The Subcommittee RECOMMENDS the *Empty Homes Tax Proposal*.

#### Reasons for recommending the *Empty Homes Tax Proposal*:

- Creating a new tax classification with a potentially significantly higher rate may cause highly variable difference in tax liability as properties shift between Residential/Residential A versus vacant residential that is misaligned with the actual use of the property.
- The property tax system is set up to determine tax liability for a future year. However:
  - Some property owners may not know if their property will be vacant.
  - Some property owners may intend to have their property occupied but change their intentions after filing their property taxes.
  - Some property owners could intentionally declare their property will be occupied in the future fiscal year while intending to leave the property vacant, and the City would have difficulty proving this to be the case and assessing a vacancy tax on the property.
- The *Empty Homes Tax Proposal* is a supplemental tax assessed retroactively. This is advantageous to the Bill 76 (2020) proposal because:
  - A property would remain classified as Residential or Residential A, and then an empty homes tax could be assessed on top of the regular property taxes owed.
  - **The supplemental tax decouples the empty homes tax from the annual property tax filing that is based on future declared use of a property.**
  - Property owners would file a declaration based on the actual occupancy of the property in the preceding year instead of filing based on a prediction of the future occupancy.
  - **The timing of the tax makes it more difficult to a property owner to avoid the tax.**
  - **The act of retroactively taxing an empty home as a supplement allows a property to be taxed based on actual occupancy during a period that has already passed, avoiding asking property owners to proactively identify their property as vacant to meet the deadline for filing annual property taxes.**
- The *Empty Homes Tax Proposal* is believed to be reasonably enforceable with an annual declaration like the declaration process for a property owner to claim the homeowner's exemption.
- The *Empty Homes Tax Proposal* is believed to be reasonably enforceable as it relies on property owners to prove occupancy for a past period of time rather than speculating with uncertainty about the future occupancy of the property.



## Nomenclature of Residential and Residential A Classifications

The Policy Subcommittee reported at the September 27 Commission meeting a discussion about potentially simplifying the property tax classifications to the following four categories:

1. Owner-occupied
2. Long-term rented
3. Short-term rented
4. Vacant

### Discussion:

- The proposal by the Policy Committee was based on the residential classifications of Maui County.
- The Maui County property taxes are tiered for all classes.
- The Honolulu County Residential A classification is tiered whereas the Residential classification is not.
- The Subcommittee discussed whether a vacant classification was recommended and determined that to be consistent with preceding recommendation on vacant residential property, the Policy Committee's proposal should be reduced to only three classifications. The three-class amended proposal would still allow for the supplemental property tax in the *Empty Homes Tax Proposal*.
- The Residential A Tiering Structure and Bill 20 (2021) is still intended for consideration by the Commission. This discussion expands the tiering structure proposed in Bill 20 (2021) to all property tax classifications.
- Creating property tax classes and tiered tax structure would allow the City to better direct its tax policy to broader community objectives that encourage or discourage use of properties for short-term vacation rentals, affordable long-term rental housing, home ownership, luxury housing, etc.

### Recommendation:

- The Subcommittee supports a three-classification residential property tax each with a tiering structure that progressively increasing tax rates on portions of a property's value above to-be-determined thresholds.
- The tables below represent a suggestion for the STRUCTURE of three property tax classifications each with three tiers of tax rates. The values and rates in the table are not a recommendation by the Subcommittee, however, these rates and tier cutoffs are based on existing Residential and Residential A rates.

Table for Residential, Owner-Occupied

Property Value	Property Tax Rate
\$0 - \$500,000	0.25%
\$500,001 - \$1,000,000	0.25% applied to first \$500,000, and then 0.35% for additional value up to \$1,000,000
\$1,000,001 and above	0.25% applied to first \$500,000, 0.35% for additional value up to \$1,000,000, and then 0.65% for additional value above \$1,000,000

Table for Residential, Long-Term Rental

Property Value	Property Tax Rate
\$0 - \$500,000	0.25%
\$500,001 - \$1,000,000	0.25% applied to first \$500,000, and then 1.05% for additional value up to \$1,000,000
\$1,000,001 and above	0.25% applied to first \$500,000, 1.05% for additional value up to \$1,000,000, and then 1.39% for additional value above \$1,000,000

Table for Residential, Short-Term Rental

Property Value	Property Tax Rate
\$0 - \$500,000	0.65%
\$500,001 - \$1,000,000	0.65% applied to first \$500,000, and then 1.05% for additional value up to \$1,000,000
\$1,000,001 and above	0.65% applied to first \$500,000, 1.05% for additional value up to \$1,000,000, and then 1.39% for additional value above \$1,000,000

## Land Value Tax Study

At the September 27 Commission meeting, the Subcommittee on Rates and Classifications was delegated the task of preparing and presenting objectives of a potential land value tax study recommendation. The following considerations were noted at the September 27 meeting:

1. A public testifier requested the Commission review the resource cost that would be incurred by such a study.
2. A study completed by Portland State University was circulated to the Commission and may be used as an example for the objectives of a Honolulu-based study.

### Discussion:

- Commissioner Pham contacted the publisher of the Portland State land value tax study and determined the cost of their study to be \$35,000 paid with a foundation grant.
- The original proposal for the Portland State study was shared as it contained their preliminary objectives, expected data sources, and methodology.



- The Portland State study specifically notes that the land value tax is criticized for overdevelopment of Waikīkī in the 1970s.
  - A counter argument to the overdevelopment criticism is that the criticism is based on a time when our community was not in an undersupplied housing crisis.
  - A counter argument to the overdevelopment criticism is that a land value tax could encourage residential development in the primary urban center, preserving currently agricultural, natural, and/or otherwise undeveloped lands.
- Concerns were expressed regarding whether this taxation model is equitable and if there are strategies to mitigate possible inequities in the transition to and continuation of a land value tax.
  - A counter argument to the perceived potential for inequity is that the study also included a review of transition strategies and mitigations for disparate impacts.
  - A counter argument to the perceived potential for inequity is that land is a fixed resource, especially in our island community, and therefore a tax that is closely aligned to the value of land could be argued as more equitable.
- **The Commission should be reminded that we are only considering whether we want to recommend a localized study of the land value tax, not a recommendation to adopt a land value tax. This would allow the Commission to express concerns and direct those concerns as study objectives.**

#### Recommendation:

If the Commission decides to recommend a land value tax study, the Subcommittee recommends the following study objectives:

- Model the effects of a land value tax using data localized to Honolulu County
- Determine the land value tax rates for existing property classifications to produce the same revenue by each classification
- Determine the effect on the supply of housing, particularly the supply of housing affordable to low-income households and real estate speculation
- Determine potential impacts on minority and low-income populations as well as potential mitigation for adverse impacts
- Determine whether owners possessing similar property attributes receive more equitable treatment under the existing real market value tax versus a land value tax
- Determine the impact on residential leasehold property owners
- Determine the correlation between land values and zoning designations
- Determine the existing zoned capacity for residential units and whether a land value tax would encourage developing into the existing zoned capacity
- Determine the effects on value and use of agriculture and farmland (Specifically, could a land value tax be used to promote local agriculture?)
- Determine the viability of a land value tax exclusively in the urban core and the results of using different taxation methods in urban-designated areas versus rural areas of Honolulu County