

5th Subcommittee on Rates and Classifications Meeting (March 7, 2022)

Honolulu Hale 2nd Floor Conference Room and WebEx

Attendees: Commissioner Jack Legal (virtual), 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 March 15, 2021.

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

1. Land Value Tax Study Recommendation
2. Comprehensive Residential Property Tax Restructuring Proposal
3. Empty Homes Tax Clarifying Recommendation(s)

Land Value Tax Study Recommendation

The Subcommittee requests the following recommendation be adopted as the recommendation of the Commission:

The Commission discussed options for long-term equitable changes to the real property tax structure. Land value taxation was discussed and explored by members of the Commission’s Rates and Classifications Subcommittee. The reason for discussing land value taxation was due to the high cost of land being the most significant contributor to the high cost of residential property in the County.

The Subcommittee reviewed a Portland State study modeling the effects of a land value tax in Multnomah County, Oregon. The cost of the study was \$35,000, paid with a foundation grant. The study modeled the effects of a split-rate tax, that is a property tax composed of separate tax rates on the value of the land and the value of the improvements.

The Commission received expert testimony at its October 21, 2021 meeting from Dr. Tom Gihring. His testimony included information about the Portland State study as a member of a community organization that supported its publication as well as an opportunity for Commissioners to ask questions about certain technical aspects of land value taxation.

The Commission believes its other recommendations to improve upon equitable property taxation in the City and County of Honolulu should be considered before a change as significant as changing the structure to a land value tax. However, should proposals be dismissed from further consideration or not produce successful outcomes, the Commission recommends the land value tax be studied with Honolulu County real property data with a primary objective to conclude the optimum split rates on land and improvements.

Comprehensive Residential Property Tax Restructuring Proposal

The Policy Subcommittee reported at the September 27 Commission meeting a discussion about potentially simplifying the residential property tax classifications. The Rates and Classifications Subcommittee discussed their proposal on October 15, 2021. Since reporting its discussion from that meeting, the issue has been tabled while the Subcommittee and Commission devoted its attention to its interim report.

The following recommendation is not intended to supersede the Commission's interim report recommending the Empty Homes Tax. The Empty Homes Tax Proposal supplements the existing residential property tax rates and classifications, keeping the issues related to occupancy independent of the "Residential" and "Residential A" classifications and rates structure.

Recommendation

The Subcommittee requests the following recommendation be adopted as the recommendation of the Commission:

The Commission proposes four actions:

1. Eliminate Residential Classification
2. Eliminate Residential 'A' Classification and associated tiered rates
3. Implement Residential Owner-Occupied Classification and four-tier rates based on annual quartiles of Real Property Assessment Division valuations
4. Implement Residential Long-Term Rental Classification and four-tier rates based on annual quartiles of Real Property Assessment Division valuations

Discussion

- The 2010 owner occupied/non-owner-occupied residential property tax classifications were discontinued after one year due to the concern for tenants residing in properties taxed at a higher non-owner rate.
 - This resulted in the establishment of the Residential A Classification that assigned a higher tax rate to higher value non-owner-occupied properties, mitigating the effects on lower value properties more likely to be leased to lower income tenants.
 - The proposal to re-instate the owner-occupied and non-owner-occupied classifications can be mitigated by setting equal rates for the lower tiers as demonstrated in the provided example.
- Implementing a tiered structure for all residential properties would provide the City and County more flexibility in executing on equitable property taxation.
 - A percentile-based tiering by residential property values would create a "closed loop system" for determining the annual cut-offs of each tier instead of indexing to outside data sources.
 - The example provided in this report tiers by quartiles, but the City and County could determine other cutoffs for percentile-based tiers may be more equitable.

- The Commission discussed and does not recommending the following options for indexing the residential property tax tiers:
 1. U.S. Housing and Urban Development (HUD)/Hawai'i Housing Finance and Development Corporation (HHFDC) annually published income guideline tables – discussed as a viable index with the ability to set tiers according to the home prices affordable at varying income levels
 2. Honolulu Board of Realtors Sale Prices – discussed as a popular metric with quarterly publication but the data only reflects market prices and does not necessarily represent the value of homes occupied by Honolulu residents; this was the basis for the percentile-based tiering recommendation as the Subcommittee discussed the merits of tiers based on the median sales price
- The Commission acknowledges the City and County may not have the technology and systems in place to execute on this proposal immediately. This proposal is for a long-term change that may require the City to invest in updating its technological resources.
- The Commission understands property tax rates are established annually according to budgetary needs and set by resolution.
 - Tax rates are subject to changes and may vary from the those provided in the example chart of this recommendation.
 - The City and County would need to determine a point in time at which the percentile tiers are set to dollar amounts as to not allow appeals to create fluctuations in the tiers later in the year.
- The Commission acknowledges Bill 20 (2021) as a basis for this recommendation, expanding the tiering structure proposed in Bill 20 (2021) to all property tax classifications.

Example Schedule of Residential Tiered Rates

Proposed Classification	1 st Quartile of Honolulu County Valuation	2 nd Quartile of Honolulu County Valuation	3 rd Quartile of Honolulu County Valuation	4 th Quartile of Honolulu County Valuation
Owner-Occupied	0.25% (lower than 0.35%)	0.35%	0.45%	0.65%
Non-Owner-Occupied			0.65%	1.39%

Notes

1. The property tax rates in the example are based on 2022 rates:

0.35% = Residential
 0.45% = Residential A Tier 1
 0.65% = Bed and Breakfast Home
 1.05% = Residential A Tier 2
 1.39% = Commercial

Notes (Continued)

2. The first tier/quartile is intentionally shown as a lower rate to demonstrate how the addition of tiers can allow for the city to provide tax relief to lower value properties, lower income property owners, and lower income tenants to achieve for equitable outcomes with the residential property tax structure.
3. The first two tiers/quartiles are the same for owner-occupied and non-owner-occupied residential classifications to mitigate concerns of property owners in the non-owner-occupied classification passing higher property taxes onto low-income tenants who are more likely to rent lower value properties.
4. The tier structure is intended to be taxed progressively in the same manner as Residential A in which all property owners would pay the same rates on the value up to each tier cutoff.

Empty Homes Tax Clarifying Recommendation(s)

The Subcommittee requests the following recommendation be adopted as the recommendation of the Commission regarding Bill 9 (2022):

Regarding the Proposal's Definition of "Empty Home"

The Commission recommended an empty homes tax in which property owners are defined empty unless qualifying for a listed exemption. The Commission does not recommend the Bill 9 language that changes this original recommendation to include "that has been unoccupied for more than six months during the previous tax year." The Commission affirms its original recommendation to rely on the exemption-based definition that already includes time-bound definitions for occupancy-based exemptions.

Regarding the Consideration of an Approach Similar to Maui County

The Commission's Rates and Classifications Subcommittee considered a method of assessing a tax on vacant residential property like that of Maui County during its preliminary discussions on comprehensive residential property tax restructuring. The Subcommittee recommended the Empty Homes Tax be separated as a "supplemental tax" so an empty homes tax could be adopted with no changes to the existing residential rates and classifications. Furthermore, the Subcommittee was concerned that any vacant residential property as a classification that is determined and taxed prospectively with respect to the tax year could allow for property owners to file their properties with intent for occupancy but intentionally or unintentionally be empty during the tax year.

The Subcommittee on Rates and Classifications still considered a comprehensive restructuring inspired by Maui County which is included in the previous section of this report.