

SB2575



STATE OF HAWAII

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT AND TOURISM
HAWAII HOUSING FINANCE AND DEVELOPMENT CORPORATION
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Honolulu, Hawaii 96813
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IN REPLY REFER TO

Statement of
Karen Seddon
Hawaii Housing Finance and Development Corporation
Before the

SENATE COMMITTEE ON EDUCATION AND HOUSING SENATE COMMITTEE ON TRANSPORTATION, INTERNATIONAL AND INTERGOVERNMENTAL AFFAIRS

February 8, 2010, 9:00 a.m.
Room 225, State Capitol

In consideration of
S.B. 2575
RELATING TO HOUSING.

The HHFDC ***opposes*** S.B. 2575 because it will serve as a disincentive for the development of affordable for-sale housing under Chapter 201H, HRS.

The Chapter 201H, HRS housing development program provides a toolbox of resources to facilitate the development of affordable housing. Affordable for-sale units developed under 201H are subject to a 10-year buyback and sharing of equity appreciation. The program increases homeownership opportunities for lower and moderate-income households by providing adequate incentives for private developers to develop safe, decent and affordable housing. The resale restrictions curb speculation, allow HHFDC to recapture any subsidy, and generate revenues for the development of additional housing units, while providing homeowners with the primary benefits of owning a home - asset building and upward mobility. Therefore, we believe the current 201H housing development program is functional and beneficial.

This measure seeks to preserve affordable housing in perpetuity. However, there are associated consequences. The homeowner's equity appreciation is limited to 1% of the original cost and capital improvements per year in perpetuity. Additionally, the homeowner must sell the unit to another qualified resident or HHFDC (but only if the homeowner cannot sell the unit within one year of listing). HHFDC will not be able to recapture any of its subsidies or generate additional revenue from the sharing of appreciation. We believe that in an attempt to achieve perpetual affordability, developers will no longer see 201H as a tool to develop affordable housing and fewer affordable units will be built.

Our comments on specific provisions in this bill follow:

Section 2 (p. 1, line 8 through p. 3, line 16). Adds a new anti-speculation capital gains tax with a sliding rate for properties resold within 2 years. Proceeds are to be deposited into the Rental Housing Trust Fund.

The HHFDC ***opposes*** the imposition of a new tax, and defers to the Department of Taxation as to the overall merits of the anti-speculation tax proposed in this section.

Section 3 (p. 3, line 17 through p. 4, line 20). The HHFDC defers to the Hawaii Public Housing Authority as to the overall merits of this section.

Sections 4-8 (p. 4, line 21 through p. 25, line 4). Amends sections 201H-47 through 201H-51, Hawaii Revised Statutes, by eliminating the 10 year buyback, shared appreciation equity (SAE) lien and deferred sales price programs. The amendments create a permanent first-time homebuyer resale restriction. The homeowner must resell to a "qualified resident", in other words, a first-time homebuyer at a price that does not exceed the price established by formula. If the homeowner cannot resell to a qualified resident, within 1 year of listing, the HHFDC may purchase the unit and resell it to another qualified resident. Deletes provisions relating to calculation of the corporation's SAE lien and deferred sales price computation. Deletes provision exempting sustainable affordable leasehold projects from SAE/buyback restrictions.

As noted above, HHFDC is concerned that the net effect of these provisions is to prevent the affordable buyer from realizing the primary benefits of homeownership - asset-building and upward mobility.

These amendments will also create a pool of affordable units that may not be marketable. This will be a significant deterrent to sales. The existing 10-year buyback and SAE have already proven to be a sales deterrent. The requirements proposed in S.B. 2575 will be an even greater deterrent to sales of affordable housing. If for sale affordable projects are not feasible because they are not marketable, no one will develop them, which negatively impacts the available inventory of affordable housing for Hawaii families.

Section 7 also adds a new subsection (h) to 201H-50 providing that purchasers/purchases recorded prior to July 1, 2010 are grandfathered in under existing law. If it is the intent of the Committees to move this bill forward, we respectfully request that this language be clarified such that this bill does not apply to developers with pre-existing development agreements for affordable housing, who are not able to close on sales of their units prior to the effective date of this bill. Our existing development agreements are premised upon the existing 10 year buyback and SAE. The significant changes proposed in this bill will create a significant burden on affordable for-sale developers, and will frustrate our existing efforts to develop affordable housing under existing development agreements.

Section 9 (p. 25, line 5 through p. 27, line 8). The HHFDC defers to the Hawaii Public Housing Authority as to the overall merits of this section.

Thank you for the opportunity to testify.

DEPARTMENT OF COMMUNITY SERVICES
CITY AND COUNTY OF HONOLULU

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DEPUTY DIRECTOR

February 5, 2010

The Honorable Norman Sakamoto, Chair
and Members of the Committee on
Education and Housing
The Honorable J. Kalani English, Chair
and Members of the Committee on Transportation,
International and Intergovernmental Affairs
State Capitol
Honolulu, Hawaii 96813

Dear Chairs Sakamoto and English and Members:

Subject: Senate Bill 2575

Senate Bill 2575 creates an anti-speculation capital gains tax on real property; requires public housing provided by county or state financing to remain affordable in perpetuity; and provides that the restriction on the resale of affordable housing to "qualified residents" shall apply in perpetuity. The Department of Community Services (DCS) strongly opposes Section 4 through 8 of Senate Bill 2575.

Section 4 through 8 of SB 2575 amends §201H-47, Hawaii Revised Statutes (HRS), to replace the ten-year buyback provisions with a permanent resale restriction. The DCS considers this to be both undesirable and unnecessary. The existing ten-year buyback period is a reasonable restriction which: 1) deters real estate speculation for an appropriate length of time; and 2) provides homeowners the opportunity to build family wealth and realize the benefits of homeownership, and, if desired, move-up to market-rate housing.

The goal of helping families transition from renting to purchasing an affordable unit would be hampered by the creation of a price restriction that runs in perpetuity. Such a restriction would serve as a disincentive to potential homebuyers who realize that the opportunity for building wealth through the accumulation of equity in their home is severely limited. Furthermore, affordable housing projects typically do not have the same amenities as market-rate housing in terms of floor area, furnishings, and other features. The modest amenities typically associated with affordable homes tend to moderate the value of units even after the ten-year buyback period expires. As such, a

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price restriction that runs in perpetuity is clearly not needed.

Section 4 of SB 2575 also deletes the provision exempting the sale or transfer of real property subject to a sustainable affordable lease from resale restrictions. This is also not necessary as the definition of a sustainable affordable lease (§516-1 of the HRS) already provides for continued affordability by limiting the lessee's maximum sales price upon resale.

Thank you for the opportunity to provide this testimony. We respectfully request your filing of Senate Bill 2575.

Sincerely,


Deborah Kim Morikawa
Director

DKM:dw

February 5, 2010

The Honorable Norman Sakamoto, Chair

Senate Committee on Education and Housing

The Honorable J. Kalani English, Chair

Senate Committee on Transportation, International & Intergovernmental Affairs

State Capitol, Room 225

Honolulu, Hawaii 96813

RE: S.B. 2575 Relating to Housing

HEARING: Monday, February 8, 2010 at 1:15 p.m.

Aloha Chair Sakamoto, Chair English and Members of the Joint Committees:

I am Craig Hirai, the Chair of the Subcommittee on Affordable Housing, here to testify on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 8,800 members in Hawai'i. HAR **opposes** Section 2 of S.B. 2575, which: (a) assesses a graduated anti-speculation tax on the capital gains realized on real property held from less than six months and up to twenty four months before being sold; and (b) deposits the realizations into the Rental Housing Trust Fund.

S.B. 2392 imposes an additional anti-speculation capital gains tax of: (a) 60% of the capital gains tax owed if real property was held by the seller for less than six months; (b) 30% of the capital gains tax owed if real property was held by the seller for six months but less than twelve months; and (c) 15% of the capital gains tax owed if real property was held by the seller for twelve months up to and including twenty-four months.

Please note that under federal and Hawai'i income tax law, gains received by a real estate dealer from his or her business operations will be taxed as ordinary income (not capital gain).

A real estate dealer is a person who buys and sells real property as a separate business, with a view to the gains and the profits derived from such sales. Whether the taxpayer is a real estate dealer or investor is a question of fact. A taxpayer may be found to be engaged in the business of buying and selling real estate by reason of the taxpayer's organization and method of activities.

The IRS is unlikely to challenge a taxpayer who claims to be a real estate dealer in order to pay tax at the ordinary income rate (which is the same as the short-term capital gains rate) and thereby avoid the anti-speculation capital gains tax under Section 2 of S.B. 2575. The entire burden of enforcing the anti-speculation capital gains tax will therefore fall on the State of Hawai'i Department of Taxation.

HAR respectfully submits that Section 2 of S.B. 2575 is unfair to small investors, will not materially impede the speculative turnover of real property in Hawai'i, and may not raise much additional revenue for the Rental Housing Trust Fund.

HAR would also note that under Sections 4 and 6 of S.B. 2575, it appears that a purchaser of an HHFDC developed property may not be able to devise the property to his or her heirs unless the heir receiving the property is a "qualified resident" who intends to occupy the property at all times.

HAR looks forward to working with our state lawmakers in building better communities by supporting quality growth, seeking sustainable economies and housing opportunities, embracing the cultural and environmental qualities we cherish, and protecting the rights of property owners.

Mahalo for the opportunity to testify.

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Anti-speculation capital gains tax

BILL NUMBER: SB 2575

INTRODUCED BY: Sakamoto & 1 Democrat

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to impose an anti-speculation, short-term capital gains tax on the net capital gains realized from the sale of real property, less commissions, fees, and other charges related to the sale. The tax shall be imposed on the seller and shall be 60% of the capital gains tax owed on the sale of real property if held by the seller for less than six months prior to the sale; 30% if the real property was held for six months but less than 12 months; or 15% if the real property was held between 12 months and 24 months.

This tax shall not apply to real property sold to provide affordable housing to a resident earning less than 140% of the median Hawaii income as determined by the department of taxation which will not be resold in less than ten years. Stipulates that the sale of unimproved real property shall be subject to this section. Requires the department of taxation to deposit all tax realizations pursuant to this section into the rental housing trust fund. Properties that qualify for a county homeowner's exemption or to military personnel selling property as a result of military relocation orders shall not be subject to this tax.

Makes conforming amendments and other nontax amendments.

EFFECTIVE DATE: July 1, 2010

STAFF COMMENTS: It appears that this measure is being proposed as a means of penalizing "speculators" as it proposes an anti-speculation capital gains tax on the "profit" realized from the sale of residential real property if the property is sold within two years after acquisition unless the property is to be utilized as affordable housing.

It should be noted that the additional tax may not deter prospective investors as there is nothing magical about holding property for a number of years before selling the property as any additional costs incurred, such as proposed by this measure, will no doubt be passed on to the buyer or figured into the selling price of the residence. Thus, the proposed measure may increase the selling price of housing in the state rather than deter so-called speculative buying.

Speculation is defined as to assume a business risk in hope of gain, especially to buy and sell in expectation of profiting from market fluctuations. Perhaps in another type of society or kind of economic philosophy, such a tax would be acceptable, if not mandatory. However, in our free-market economy speculation is encouraged. Unfortunately, when the speculation is in real estate or more specifically in homes, it elicits a negative response from a community where the availability of housing is limited. Thus, perhaps if one were to point a finger of blame for the rise in the cost of housing, it should be at government. With restrictions on conversion of lands from other uses to urban use and numerous

regulations, building codes, infrastructure standards, lengthy approval processes, etc., it is no wonder that the supply of housing cannot meet the current demand. A good investor will see that where supply is limited, there is no doubt that prices will increase as the supply becomes even more constricted.

Speculation and the responding taxes were quite popular years ago when “foreign investors” invaded the real estate market and homeowners and commercial properties were eager to cash in on their real estate holdings. Once those investors left, the economic doldrums of the 1990’s set in where many residents were over their heads in debt as the equity in their residences sank below mortgage levels. Those who were caught in this vacuum discovered that real estate is an illiquid and risky investment. Unlike a savings account, the funds invested in real property cannot be shifted or recouped very quickly nor do they pay a guaranteed interest rate. Property investors will buy and sell when conditions are most favorable. That favorable moment may occur within two years after purchase or it could occur in ten years after purchase. The market dictates when and if conditions are favorable for a sale of assets. A tax, such as this measure proposes, merely skews the market and may, in fact, deter any investment as there is the risk of incurring the tax should the asset be sold within the prescribed period.

A measure such as this speculation tax fails to recognize the forces and factors which make for an attractive environment in which to do business, one that recognizes that no investor plunks his money down so he can take a loss. If enacted, this measure would send out strong signals to investors that Hawaii is not a good place to invest capital if there is the potential that the philosophy reflected in this proposal will be extended to other types of investments whether it be real or personal property. Without the influx of new capital, the potential for economic growth in Hawaii will continue to be dismal.

While the proposed measure would earmark the receipts from the proposed tax into the rental housing trust fund, it should be remembered that earmarking such receipts should be approached with extreme caution. Reliance on an activity that may be affected by the tax imposed forebodes the inadequacy of the revenues to be realized. If the tax is successful in deterring quick turnovers of such land, then the revenues may prove to be insufficient to accomplish the goals of the fund.

On the other hand, if investors find the new tax a matter of course for doing business and investing in such land, then there may be a plethora of revenues for the fund. But, at the same time, it must be realized that the cost of the tax will be passed on to subsequent purchasers and the cost of all such real estate will continue to escalate at a much faster pace. So what is taxed as a “speculative” sale may be offered for owner occupancy somewhere down the line; however, the cost to the potential owner-occupant will have been artificially inflated by the amount of the speculation tax. The result is that all similar properties will rise in cost as other owners believe their properties can command a similar asking price.

Instead of such draconian measures as this tax represents, lawmakers should be searching for ways to make Hawaii an attractive place to do business, to streamline the permitting and land use process, to provide the supporting infrastructure to the agricultural community that is so desperately needed, and reduce the burden of taxes and the commensurate spending that drives the greed for new and more revenues. Structural reform is needed in a community where government is the intimidating giant overshadowing the private sector that produces the jobs needed by Hawaii’s people. It is time that lawmakers took a long hard look outside their ivory towers and if they did, measures such as this would never be forwarded.

One of the economists contracted for the 1989 Tax Review Commission was asked to look at the issue of nonresident investment and speculation in real estate in Hawaii which was rampant at the time and her conclusion was:

External investment has played a significant role in the growth and development of Hawaii's economy, and it appears that the state will continue to depend on external sources of capital. This creates a difficult problem for tax policy when returns to foreign investors are not taxed the same as returns to resident or domestic nonresident investors. On the one hand, discriminatory taxation is unconstitutional with negative impacts on desirable capital flows; on the other hand, uncaptured capital gains on foreign investment is a violation of the equity principle. . . . New capital formation has positive net benefits for the state. Policy changes should not act to discourage such investment. Indeed, they should encourage new capital formation. . .

In the drive for affordable housing, it is government that is the culprit, exacting costly requirements that delay the timely delivery of such housing and, in turn, drive up the cost. One has to also question whether or not all of the tax incentives thrown at the construction industry during the past half dozen years drove the cost of construction higher at a much faster pace making the term affordable housing an oxymoron.

Digested 2/5/10