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Senator David Y. Ige, Chair and Senator Michelle N. Kidani, Vice Chair
Senate Committee on Ways and Means

Recommended amendments to SB 654, Relating to Taxation (Provides a temporary tax credit for residential construction and remodeling projects. Requires report to the legislature comparing impact on jobs and the state budget for various tax credit applications. Sunsets 12/31/13.)

Decision-Making: Tuesday, March 1, 2011 at 9:20 a.m. in CR 211

My name is Dave Arakawa, and I am the Executive Director of the Land Use Research Foundation of Hawaii (LURF), a private, non-profit research and trade association whose members include major Hawaii landowners, developers and a utility company. One of LURF's missions is to advocate for reasonable, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources and public health and safety.

LURF appreciates the opportunity to provide testimony **generally supporting the intent of SB 654**, which provides for a residential construction and remodeling tax credit to individual taxpayers who own real property, and to provide **comments, concerns and recommendations to amend SB 654 to include the text of SB 771**, which would further specify and define terms, as well as add provisions in order to limit the application of the proposed tax credit to Hawaii's residents and workforce, and to avoid issues otherwise anticipated with respect to the eligibility requirements thereunder.

SB 654. This bill establishes a residential construction and remodeling tax credit for individual taxpayers who own real property and who incur construction and remodeling costs related to new construction, alterations, or modifications of a residential apartment unit or house. SB 654 shall apply to taxable years beginning after December 31, 2010, and ending prior to January 1, 2014.

BACKGROUND

The bill is consistent with State actions proposed by the Construction Industry Task Force. In 2009, the Construction Industry Task Force ("CITF") was established pursuant to Senate Concurrent Resolution No. 132, S.D. 1 (2009) ("SCR 132") to determine the direct economic contributions of the local construction industry to the local economy, including the industry's impact on related industries such as housing. As directed in SCR 132, the CITF was tasked with developing a series of proposals for State actions to preserve and create new jobs in the local construction industry, thereby promoting overall economic growth. In doing so, the CITF's Tax & Incentives Committee made several recommendations to establish or increase tax credits to encourage continued development. Since that time, a number of bills proposing tax credits relating to the construction, development, or purchase of property, including the subject bill, have been introduced with the intent to implement the recommendations made and State actions proposed by the CITF.

If amended to be consistent with SB 771, SB 654 could conform to the recommendations made by the Governor's Task Force on Affordable Housing Barriers. Over the past years, LURF also participated in the Governor's Affordable Housing Regulatory Barriers Task Force, a statewide task force comprised of representatives from all four counties, business, labor, developers, architects, nonprofit providers of services, the State, and the legislature, whose purpose was to identify, address and propose regulatory reform and solutions to remove the barriers to the production of affordable housing (Governor's Task Force"). After finding that Hawaii's regulatory system has created a housing development environment that severely restricts the State's housing supply and impacts the cost of homes, the Governor's Task Force recognized the need for **incentives** for affordable housing development. Unfortunately, the current version of SB 654 proposes tax credits that could easily be used up by millionaires as an incentive to build or remodel their multi-million-dollar homes luxury kitchens, bathrooms or swimming pools. If, however, the text of SB 771 and its income restrictions are added to SB 654, this legislation would truly become an incentive to help address Hawaii's affordable housing problem.

If the provisions of SB 771 are added to SB 654, that portion of the bill will be analogous to tax credit legislation enacted in California. SB 771 is conceptually analogous to legislation enacted by the State of California effective May 1, 2010 (which allocated $100 million for state tax credits to buyers of new, unoccupied homes), in that the intent of both measures is to utilize tax credits as part of the State's effort to revitalize the economy by stimulating the local construction industry. (*See* attached article entitled, "Schwarzenegger Expected to Sign New $10,000 California Homebuyer Tax Credit" which appeared in the March 24, 2010 edition of the *Sacramento Bee.*)

In the *Bee* article, California Assemblywoman, Anna Caballero stated that "[t]his tax credit has a proven track record. California's construction industry reported a 39 percent increase in building permits after the first round of tax credits began in March 2009 and proved even more popular than expected." The article also pointed to the fact that the housing stimulus was proposed by Governor Schwarzenegger in his January 2010 State of the State Address, to help revive the California economy.

Thus, if the provisions of SB 771 are added to SB 654, then SB 654 will become, in essence, the Hawaii counterpart of the California legislation, intended to stimulate residential construction and could move residential projects and Hawaii's economy forward.

LURF'S POSITION

- **LURF generally supports the intent and purpose of SB 654 but strongly recommends amendment of the present form of the bill to add the text of SB 771, which will limit its application to the target group it is intended to help.**

  LURF supports the intent and purpose of this bill, which is to create a construction and renovation tax credit for residential construction and remodeling projects, thereby stimulating the construction industry and creating jobs in Hawaii. However, if the text of SB 711 were added to SB 654, the bill would provide much-needed affordable housing and more benefit the construction industry, as well as the overall economy.

➢ **Should SB 654 be amended to include the provisions of SB 771, it will provide incentive for developers and property owners to construct, improve or expand affordable housing , thereby revitalizing the local construction industry.**

The lack of affordable housing remains a significant problem affecting Hawaii and Hawaii's families. Finding ways to provide sufficient affordable housing and market housing for Hawaii's residents has been a major objective for our elected officials, state and county agencies, and members of the housing industry and business community. If the provisions in SB 711 are added to SB 654, this bill could incentivize the construction of affordable housing, and the expansion and renovation of residences, thereby addressing the need for affordable housing, and in turn, boosting the local construction industry.

➢ **If SB 654 is amended to include the provisions of SB 771, which encourages new affordable housing, it could help to revive the construction industry, and also aid in stimulating the State's economy.**

Should SB 654 be amended to include the text of SB 771, it could help provide much-needed affordable and market housing, and SB 654 could stimulate the economy and assist in getting people back to work. This measure will increase construction jobs, and in doing so, bring relief to the State's unemployment rate. Hawaii is presently in need of economic stimulus and other initiatives to counteract the negative impact that the world and national economies has had on the State's fiscal condition. According to recent economic forecasts by First Hawaiian Bank and the University of Hawaii Economic Research Organization, the local construction industry will continue to be impacted for some time before a gradual recovery ensues. LURF understands further that while the amount of public works has increased over the years to help support the local construction industry, private construction makes up nearly two-thirds of the industry's total volume and continues to be hindered by the current economic conditions.

Back in 2001, in response to the effects of the September 11th terrorist attacks on the United States which had a devastating effect on Hawaii's economy, the Legislature met in special session to approve certain emergency measures. One such response was the enactment of Act 10, Third Special Session Laws of Hawaii (2001), which enhanced the then-existing hotel construction and remodeling tax credit. Act 10 raised the tax credit from four to ten percent for costs incurred prior to July 1, 2003 in order to assist the tourism industry in its efforts to attract more visitors to Hawaii, and to spark the local construction industry. Act 10 provided the stimulus needed to boost Hawaii's workforce and economy during past difficult economic times.

If the provisions are SB 771 are added to SB 654, LURF believes that the tax credit proposed by SB 654 would be an effective mechanism to assist in current efforts being made by the Legislature to revitalize Hawaii's workforce and economy.

With the provisions of SB 771 included in SB 654, the bill could implement the legislative recommendations of that task force, the findings of the Discussion Group, as well as the State actions proposed by the CITF, by addressing the immense need to provide affordable housing in Hawaii, and thereby effectively furthering the public interest and general welfare of the State.

➢ **LURF has concerns, however, regarding the form of SB 654, and strongly recommends that SB 654 be amended by adding the text of SB 771**; particularly the need to further specify and define terms, as well as add provisions in order to direct

application of the bill to taxpayers to which the measure is intended to apply, and to avoid issues relating to eligibility requirements.
As presently drafted, SB 654 lacks the specificity necessary to limit application of the tax credit as intended, to amongst other things, the following:

- "newly constructed principal residences" (new structure built from ground up);
- taxpayers whose "principal residence" is located in this State (lives in Hawaii more than 270 calendar days per calendar year);
- "qualified principal residences" (used by taxpayer as principal residence for the two years immediately following the date of receipt of certificate of completion; non-residency or sale should result in recapture of the previously claimed tax credit);
- "qualified taxpayers" (who meet adjusted gross income limitations); and
- "qualified purchase price" ($625,000 or less).

To demonstrate the absurdity of SB 654 as currently drafted, the bill would hypothetically enable a foreign, non-resident millionaire who invests in Hawaii property to claim and collect the proposed tax credit for remodeling a bathroom in one of his many multi-million dollar luxury vacation homes before putting it up for sale.

It is thus recommendable for supporters of SB 654 to incorporate the above definitions/provisions to appropriately support the purported intent of the bill, and to avoid misapplication of the measure to, and misuse of the proposed credit by ineligible taxpayers.

Below is a chart comparing the provisions of the subject bill with SB 771 (proposing to establish an ohana residential housing tax credit), which LURF believes more appropriately defines eligibility requirements for the tax credit proposed therein.

COMPARISON OF SB 771 and SB 654

	SB 771 Ohana Residential Housing Tax Credit	**SB 654 Residential Construction and Remodeling Tax Credit**
Eligible structures	**"Newly constructed principal residence"** New structure built from ground up, includes single-family home, duplex, condominium, manufactured home or townhouse.	**NO REQUIREMENT that construction or remodel must be on a principal residence of taxpayer.** Any construction, remodeling, or equipment permanently affixed to a building or structure related to new construction, alterations of a residential apartment unit or house.

Taxpayer Residency Requirement	**Residency requirement:** Applies only to **"principal residence,"** which means an individual's principal residence, located in the state **where the individual <u>lives for more than two hundred seventy calendar days</u> per calendar year.**	**NO DEFINITION; No requirement that taxpayer must be a Hawaii resident, or have a principal residence in Hawaii;** Tax credit can be for a **vacation home or income-producing rental apartment units.**
"Qualified principal residence"	Received certificate of completion on or after April 1, 2011; **Residence must be used by taxpayer as taxpayer's principal residence for the immediately following two years; and is eligible for homeowner's exemption**	**NO DEFINITION: No requirement that tax payer must live in the structure.** Tax credit can be for a **vacation home or income-producing rental apartment units.**
"Qualified Taxpayer"	**Intent to help "Workforce Housing" buyers:** Must meet adjusted gross income limitations: Individual with AGI of $75,000 or less; Couple with AGI of $150,000 or less; or grantor of any trust with AGI of $75,000 or less. Must sign a binding contract to purchase a qualified principal residence between 4/1/11 and 1/1/13; provided that closing is on or after 4/1/11 and before 3/1/13.	**NO DEFINITION; NO INCOME LIMIT FOR TAXPAYERS.** Can be used by local workers for an affordable home, but **can also be used by millionaires and other high-income people to renovate their kitchens, bathrooms, pools, residential income-producing properties, etc.** Tax credit will be available to anyone who owns residential real property in Hawaii and pays Hawaii taxes.
Purchase Price	**Limited to qualified principal residences of $625,000 or less**	**NO DEFINITION, NO LIMIT:** Tax credit could be used for **multi-million dollar luxury vacation homes or income-producing residential units and any multi-million dollar renovation of a kitchen, bathroom, pool, etc.**
Recapture of tax credit if residence is sold or not living in qualified principal residence	**If Taxpayer sells, or no longer uses the qualified principal residence as taxpayer's principal residence, within 730 days after closing, then the taxpayer shall be subject to recapture on the previously claimed tax credit** on a pro-rata dollar-for-dollar basis.	**NO DEFINITION, NO RECAPTURE OF TAX CREDIT:** Taxpayer may sell or rent the residence at any time after receiving the tax credit, without having to repay the tax credit to the State.

It is LURF's position that SB 654 should be amended to include, at the very least, those identical or similar definitions and provisions from SB 771, to assure that the proposed tax credit will be limited to providing affordable housing for working local residents.

CONCLUSION

LURF **supports the general intent of SB 654, as long as it includes the text of SB 711,** because by including such revisions, the bill will be an attempt to implement the legislative recommendations of the Governor's Task Force, as well as the State actions proposed by the CITF, by addressing the immense need to provide affordable housing in Hawaii, and thereby promoting the local construction industry, stimulating the economy, and furthering the public interest and general welfare of the State.

However, despite of our general support of the underlying intent of SB 654, **LURF respectfully urges that the current draft of the bill be reviewed and amended to incorporate the more specific language of SB 771, which is necessary to carry out the purported providing affordable housing for Hawaii's working residents and to avoid misapplication of the proposed tax credit to the most affluent of Hawaii's taxpayers.**

Thank you for the opportunity to present testimony regarding this matter.

Attachments

THE SACRAMENTO BEE sacbee.com

More Information

- California homebuyer tax credit sought again
- Schwarzenegger proposes tax credit to spark new home building
- California Senate approves $10,000 tax credit for new-home buyer:
- California tax credit for new-home buyers bearing fruit

Schwarzenegger expected to sign new $10,000 California homebuyer tax credit

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Homebuyer tax credits are almost certainly returning.

Sacramento-area buyers can begin claiming $10,000 tax credits starting May 1 under a bill expected to be signed soon by Gov. Arnold Schwarzenegger.

The legislation allocates $200 million for more state tax credits – twice what was offered last year to 10,659 buyers of new, unoccupied homes. The state's newest housing stimulus will grant $100 million in tax credits to first-time buyers of existing homes and $100 million to anyone who buys a new, unoccupied home.

The state Franchise Tax Board on Tuesday estimated nearly 32,000 homeowners statewide might get the tax breaks. Buyers must close escrow or reserve a credit on or after May 1 and before or on Dec. 31 to qualify.

The bill, AB 183, passed both houses of the Legislature by near unanimous votes. But one local lawmaker, Assemblyman Roger Niello, R-Fair Oaks, voted against it.

"I think it's a lot of money in a deficit situation that doesn't have the desired benefit," Niello said Tuesday, noting that housing prices are still depressed despite earlier credits designed to stimulate the market.

Niello's view was clearly a minority one, however.

"This tax credit has a proven track record," said Assemblywoman Anna Caballero, D-Salinas, who authored the bill along with Sen. Roy Ashburn, R-Bakersfield. Caballero said California's construction industry reported a 39 percent increase in building permits after the first round of tax credits began in March 2009 and proved more popular than expected. It ran out last July 2.

Schwarzenegger spokesman Mike Naple said Tuesday the governor supports the bill "and is expected to sign it."

The governor signaled his intent Monday while signing two other budget bills. In a signing message, he commended the Legislature for approving the tax credit bill, saying it will stimulate "the housing industry, creating jobs for thousands of Californians."

Schwarzenegger proposed the housing stimulus in his January State of the State Address to help revive the

California economy. The new state tax credit would take effect one day after expiration of a federal $8,000 tax credit for first-time homebuyers.

As was the case last year, buyers won't be eligible for the full $10,000 credit if they owe the state less than that amount over a three-year period. Buyers can get up to $3,333 off their tax obligation in each of the thre years after buying a house.

Buyers must be at least 18 years old and be unrelated to the seller. They must live in the home they buy. First-time buyers are defined as those who have not owned a home in the past three years.

The Franchise Tax Board estimates the tax credit will cost the state $6 million for the fiscal year ending Jun 30 and $69 million next year. For three years after that, it will cost the state treasury $67 million, $54 million and $4 million.

This year's legislation is different in that it allows buyers of new homes to reserve a tax credit in advance. A buyer signing a sales contract in June can claim the credit in November when the house is completed, a capital-area building industry official said Tuesday.

"In our parlance, that allows dirt sales," said Dennis Rogers, a vice president at the Roseville-based North State Building Industry Association. "We'll be able to build new houses now and get jobs going."