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February 17, 2011

Senator Carol Fukunaga, Chair and Senator Glenn Wakai, Vice Chair
Committee on Economic Development & Technology

Testimony of the Land Use Research Foundation of Hawaii <u>in support</u> of SB 771, Relating to Economic Recovery. (Establishes a refundable ohana residential housing income tax credit for qualified taxpayers that purchase a qualified principal residence on or after April 1, 2011, and before January 1, 2013, that is payable to the qualified taxpayer in two equal installments over the immediately following two taxable years.)

Thursday, February 17, 2011 at 2:45 p.m. in CR 224

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 **<u>in strong support</u> of SB 771.**

<u>SB 771</u>. This bill establishes a refundable ohana residential housing income tax credit for qualified taxpayers who purchase a "qualified principal residence" which is defined as "a principal residence that is a newly constructed principal residence completed on or after April 1, 2011; is used by the taxpayer as the taxpayer's principal residence for the immediately following two years; and is eligible for the homeowner's exemption. The tax credit is payable to the qualified taxpayer in two equal installments over the immediately following two taxable years. Upon adoption, the Act shall apply to taxable years beginning after December 1, 2010.

This bill is comparable to legislation enacted by the State of California, effective May 1, 2010, which allocates $100 million for state tax credits to buyers of new, unoccupied homes.

<u>Background</u>.

SB 771 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.

The bill conforms 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 ("Governor's 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. 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 Task Force recognized the need for **incentives**, such as the subject bill, for affordable housing development.

The bill is similar to tax credit legislation enacted in California. SB 771 is also 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.

SB 771 is, in essence, the Hawaii counterpart of the California legislation, intended to stimulate residential construction and move residential projects forward.

<u>LURF's Position</u>. LURF supports SB 771, which proposes the establishment of a residential housing tax credit to stimulate the local construction industry, thereby creating jobs, providing much-needed affordable housing, and improving the State's overall economy.

- **The bill will provide incentive for property owners to construct new residences, 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. This bill will assist in this effort by incentivizing the construction of residences, thereby addressing the need for affordable housing, and in turn, boosting the local construction industry.

  With respect to construction and the construction industry, the proposed tax credit will:

  - **Make it easier for home buyers to qualify for financing and to purchase affordable homes costing $625,000 or less.**

- **Produce hundreds of units of affordable housing units.** In addition to the increased construction of homes at or under $625,000, even more affordable homes will be built based on the fact that developers must comply with County affordable housing requirements (e.g., on Oahu, 30% of total units are required to be affordable; Neighbor Islands have different affordable housing requirements).

- **Encourage construction of housing units which would otherwise not be built due to current economic and financing circumstances.** As mentioned previously in this testimony, California experienced a **39% increase in building permit applications** in 2009 as a result of that state's enactment of a similar tax credit law. The attached *Honolulu Advertiser* article dated April 4, 2010, includes DBEDT statistics proving that the number of private residential building permits is declining to the lowest point in 30 years, and confirms that the major housing developers do not plan to increase their production of units in the next few years.

  Opponents of this bill will likely claim that construction of new homes will take place in any case – with or without such tax credits. The following, however, confirms that the construction of new homes is presently declining, and that such a tax credit would spur an increase in the number of newly constructed homes:

  - The **39% increase in California building permits** (over the previous year) following enactment of legislation similar to SB 771 is evidence that the California tax credit was responsible for substantially increasing construction over what would have otherwise been built.

  - **DBEDT statistics show that the private residential building permits are steadily declining to the lowest point in 30 years.**

  - **Based on the economy and other factors, Hawaii's major developers do not plan to build many new homes in the near future.** LURF has testified and explained to the House Finance Chair and Housing Chair that developers have been holding back construction, due to the economy, financing and the lack of qualified buyers. Developers do not want to construct units which must sit vacant for months, or sell the units at prices below cost. (*See* attached April 4, 2010 *Honolulu Advertiser* article which includes statements of the major Hawaii developers.)

➢ **By helping to reviving the construction industry, the bill will in turn help to stimulate the State's economy.**

In addition to providing much-needed affordable and market housing, SB 771 will stimulate the economy and assist in getting people back to work. This measure will increase construction jobs, and in doing so, reduce the State's unemployment rate.

- **The loss of jobs may be avoided and more jobs created in the following construction-related professions and trades:**

  - Consultants (planners, architects, engineers, financial analysts, market analysts and environmental consultants);
  - Government (elected officials, processors, permitting, inspections, documentation),

- Development (project managers, cost accountants, admin aides, real estate agents, marketing, advertising, legal, computer systems),
- Construction (heavy equipment operators, carpenters, plumbers,
- Electricians, masons, roofers, painters etc.), and
- Finance advisors (mortgage lenders, underwriters, appraisers, escrow/title companies and insurance).

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.

- **Tax credits will be offset by increased State tax revenues relating to the sales of millions of dollars' worth of building and construction materials; the increase in employment in industries related to development and construction; as well as by the "multiplier effect," when those employed in the construction-related industries spend their salaries on other goods and services, generating even more state tax revenue.** LURF understands that substantial general excise tax and income tax revenues will be generated by the increase in development and construction generated by SB 771. Such tax revenues are expected to more than offset the state funding of the tax credits.

Conclusion. Based on all of the above, LURF believes that the proposed tax credit would be an effective mechanism to assist in current efforts being made by the Legislature to revitalize Hawaii's workforce and economy, and therefore **strongly supports SB 771**. The bill attempts 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 housing, including affordable housing, in Hawaii, and will thereby promote the local construction industry, stimulate the economy, and further the public interest and general welfare of the State.

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

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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

By Jim Wasserman
jwasserman@sacbee.com
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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 three 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 June 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."

Honolulu Advertiser
Posted on: Sunday, April 4, 2010

Spike in Hawaii home prices on the horizon

by Andrew Gomes

Advertiser Staff Writer

Hawai'i home sales volume has been rising for nearly a year, but the pipeline to produce new homes is at a more than 30-year low, leading a local economist to warn that a price spike could be in the making.

A jump in prices isn't likely in the next year or two, based on projections by the University of Hawai'i Economic Research Organization, which forecasts that median home prices on O'ahu will eke out roughly 1 percent gains this year and next.

But 2012 or 2013 could be the beginning of the next significant rise, which has the potential to be steep.

Several factors, such as interest rates, credit availability, the depth of the foreclosure problem and growth in jobs and personal income will play into whether home prices get pushed up again and to what degree. So a run-up in prices isn't certain.

Home production, however, can be a major influence on prices, and residential building permits statewide last year sank to their lowest level since at least 1980, according to state statistics. Older statistics weren't available.

Paul Brewbaker of local consulting firm TZ Economics said home prices could "light up" in two or three years based on the dearth of residential building permits from homebuilders last year.

According to the state Department of Business, Economic Development and Tourism, there were 2,722 private residential building permits last year. That compared with 4,768 the year before and a recent peak of 9,706 in 2005.

Brewbaker said the present pace of home production won't keep up with natural household formation, that is demand generated by the present population as young adults form new families who seek their own housing.

Around 4,000 new homes are needed to satisfy household formation, the local economist said, adding that if home construction doesn't pick up it could lead to a short supply that drives another spike in prices.

The last time the number of residential building permits was under 4,000 was 1998 at the tail end of the last housing market slump that lasted roughly a decade. That year there were 3,356 permits.

"There are very few houses being built," said Carl Bonham, director of UH's economic research group. "We are setting ourselves up for a shortage down the road."

RELATIVELY FLAT NOW

Many local real estate observers like to say that Hawai'i home prices have had a historical tendency to move in a stairstep pattern — up, flat, up, flat — over multi-year cycles.

O'ahu's market is now in its third or fourth year of more-or-less flattening, but high-volume homebuilders with land to build on aren't planning to ramp up production soon.

Meanwhile, three master-planned communities totaling up to almost 29,000 homes in Central and Leeward O'ahu have been either derailed or delayed.

High-volume home builders active in Hawai'i say they saw decreasing buyer demand unfolding about four years ago, and began adjusting production so they didn't have a glut of unsold inventory.

Now homes are more or less being built to order, with little or no speculative development.

A report released last month by local real estate market researcher Ricky Cassiday noted that Hawai'i homebuilders produced and sold the fewest new homes in at least 30 years.

Cassiday's report said statewide sales of new homes totaled 2,050 last year — fewer than half the recent peak of 4,842 in 2006, and a 40 percent decline from 3,071 sales in 2008.

The moves by most Hawai'i homebuilders to avoid getting caught with lots of empty homes have helped them survive and also helped overall home prices from dropping more than a modest amount. But now that a market recovery appears to be under way, builders are remaining cautious.

"The strings are pretty tight with not getting exposed to the market," said Mike Jones, president of the local Schuler Division of residential developer D.R. Horton.

Schuler's pipeline for near-term production includes about 60 homes at Sea Country in Mā'ili, 60 at Kahiwelo in Makakilo and about 20 at Nanala in Kapolei, as well as three projects on Maui and a couple on the Big Island.

Developing additional subdivisions in Makakilo and Kapolei will require hefty investment in infrastructure, and Jones said Schuler needs to see some signs that such investment will pay off before it proceeds.

Another major Hawai'i homebuilder, Gentry Homes, also dialed back production a few years ago and isn't projecting picking up its pace this year.

"We were very careful with our spending and with our inventory levels so we didn't have the product sitting there," said Bob Brant, Gentry president and chief executive officer.

Brant and Jones said they are keenly waiting to see what happens to the uptick in home sales after federal tax credits for home purchases expire at the end of this month.

If purchases stay healthy without the credit, it could encourage developers to disengage the brakes on building.

PROJECTS UNCERTAIN

Still, some observers wonder how much builders can ramp up production if demand continues to build over the next year or two.

Two massive housing projects planned for O'ahu are uncertain, while a third could be near gaining a key approval but is still at least a couple of years away from delivering initial homes.

One uncertain project is Ho'opili, proposed by Schuler for up to 11,750 homes on the 'Ewa Plain. The developer had anticipated delivering the first Ho'opili homes in 2012 if it could obtain regulatory approvals for the highly contentious project. In August, however, the state Land Use Commission ruled that Schuler's petition to urbanize 1,554 acres of farmland was deficient.

Jones said his firm is working on addressing issues with the Ho'opili petition, but is uncertain when it may return to the LUC to seek approval.

Another uncertain master-planned community is Waiawa Ridge, which has regulatory approvals for 10,000 to 12,000 homes on 3,700 acres near Mililani. The last estimate was for initial home deliveries to begin this year, but construction had been delayed and the developer, an affiliate of Gentry, lost its right to develop the land owned by Kamehameha Schools last year.

A third major pending project is Koa Ridge by Castle & Cooke, adjacent to Mililani.

Castle & Cooke is expected to receive a decision this week from the Land Use Commission on redistricting 768 acres of farmland for the project planned for 5,000 homes.

Castle & Cooke had hoped to start delivering Koa Ridge homes upon finishing Mililani, which happened last year. But the plan in the works since the mid-1990s has been delayed several times. If the developer receives approval, the first homes could be finished in 2012.

A couple of other big projects involving the James Campbell Co. — Makaiwa Hills with 4,100 homes near Makakilo and Kapolei West with 2,400 homes — have necessary zoning but are on development timetables to deliver initial homes in 2014 or 2015.

Haseko Homes is still developing in 'Ewa Beach, but is building the Hoakalei Resort with 2,350 higher-end resort homes after recently completing the 2,500-home Ocean Pointe community.

New high-rise condominiums could be built to satisfy demand, but they generally take a few years to develop.

Cassiday said the relatively low inventory of previously owned homes that are for sale is another factor that could press prices skyward if demand surges and inventory doesn't grow.

"No matter what you say, Hawai'i is undersupplied in housing," he said.

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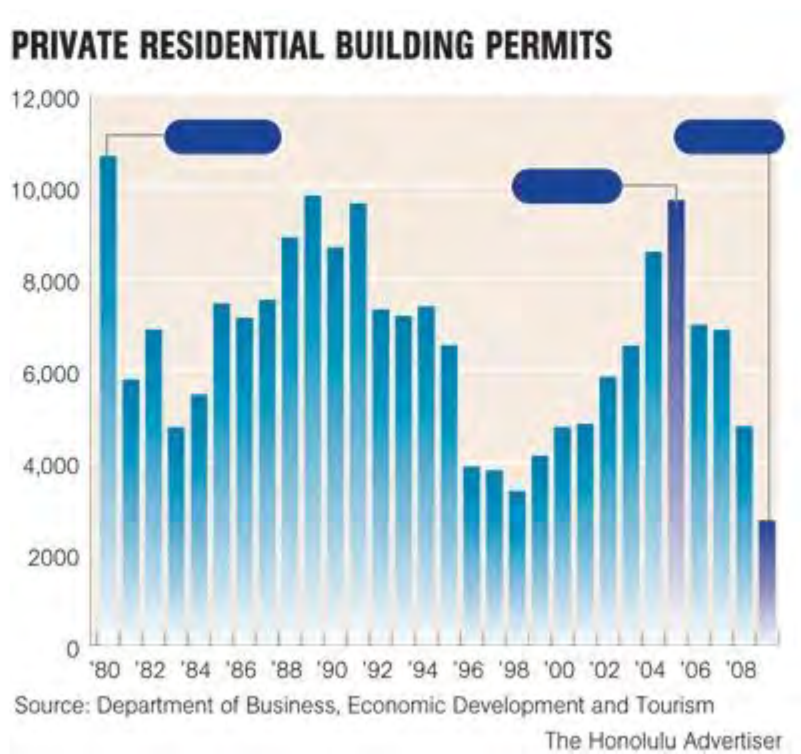

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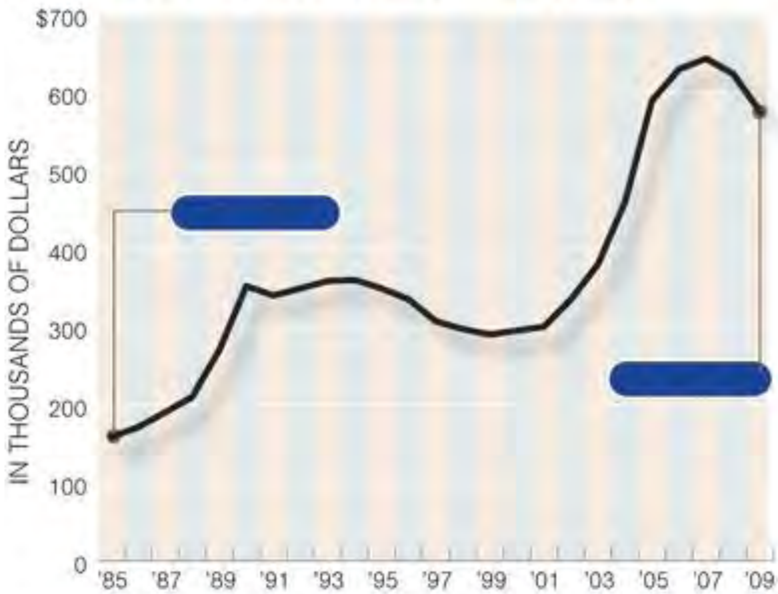
O'AHU MEDIAN SINGLE-FAMILY HOME PRICE



Source: Honolulu Board of Realtors   The Honolulu Advertiser