NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

WRITTEN TESTIMONY OF

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NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS
IN OPPOSITION TO H.B. 1012, H.D. 1

BEFORE THE HAWAII HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCE
HONORABLE SYLVIA LUKE, CHAIR
HONORABLE TY J.K. CULLEN, VICE CHAIR

HEARING ON H.B. 1012, H.D. 1

FEBRUARY 23, 2017
12:00 P.M.

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Chair Luke, Vice Chair Cullen, and members of the Committee on Finance,

The National Association of Real Estate Investment Trusts (NAREIT)[1] thanks you for this opportunity to submit testimony in **strong opposition** to H.B. 1012, H.D. 1, which would "temporarily" (for 15 years) eliminate the dividends paid deduction (DPD) for REITs except with respect to certain dividends from affordable housing.

NAREIT opposes H.B. 1012, H.D. 1, because it is contrary to federal income tax rules and the existing laws of virtually every other state with an income-based tax system. Enacting this proposal would double tax REITs and signal Hawaii's discouragement to long-term capital investment. This would potentially result in a reduction of millions of dollars of new REIT investment, a shift in property ownership to tax-exempt owners like pensions and endowments, and loss of revenue and significant jobs generated by REITs to the State. Accordingly, NAREIT respectfully asks this Committee to hold H.B. 1012, H.D. 1.

REITs are a way for people- including Hawaii residents and others – to own professionally-managed, rental real estate. Created by Congress in 1960, REITs are corporations that combine the investment dollars of many investors to own and operate rental properties that may include apartments (like Douglas Emmett's Waena Apartments, which provides workforce housing); theme parks (like CNL Lifestyle Properties' Wet'n'Wild Hawaii); shopping centers (like General Growth Properties' Ala Moana Center and Washington Prime Group's Pearlridge Center); hotels (like American Assets Trust's Embassy Suites at Waikiki Beach Walk), healthcare facilities (like Healthcare Realty Trust's Hale Pawaa medical office building), offices, and storage facilities. There are about 20 Securities and Exchange Commission (SEC)-registered REITs that have invested about $4 billion (as of Dec. 31, 2015) in over 70 Hawaii properties (worth approximately $7.7 billion, based on the equity market capitalization of all equity REITs in the FTSE NAREIT All REITs Index as of Dec. 31, 2015).

Unlike partnerships, LLCs or other C corporations, REITs are legally mandated to distribute all their taxable income to shareholders as dividends so their income is taxed once – at the shareholder level. In exchange for meeting this distribution requirement, federal law grants REITs a DPD. Like every other state with a corporate net income tax but New Hampshire, Hawaii follows federal law and allows a DPD. Thus, the income generated by REITs is reported by, and income taxes on such income are paid by, the shareholders of these companies to their state of residence. In fact, NAREIT's membership includes almost 200 public REITs and hundreds of REIT mutual funds invested in those REITs. Many of these REITs (and the funds that own these REITs) own **no properties** in Hawaii yet distribute millions of dollars in dividends – taxable by Hawaii – to thousands of Hawaii shareholders. Hawaii is able to tax these dividends even though the rental income underlying the dividends is earned in other states.

REITs benefit Hawaii by paying millions of dollars in taxes, creating jobs, and helping local communities. Hawaii economist Dr. Paul Brewbaker conducted a 2015 study on behalf of NAREIT that concluded that "[i]n just the past year REITs were associated with more than 11,700 jobs representing labor earnings of nearly $500 million and $95 million in tax revenue in Hawaii." In fact, REITs –like other commercial property owners - pay millions of dollars in general excise taxes (GET), property taxes and conveyance taxes. By investing hundreds of millions of dollars in property upgrades, their tenants generate even more in GET revenue. For example, Taubman's International Market Place (which opened last summer) is expected to pay in this current year over $1 million in

[1] NAREIT is the worldwide representative voice of real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets.

general excise tax and over $3 million in property taxes. Taubman also paid in total over $1.5 million in local conveyance taxes. The development of the center resulted in employment of over an estimated 1,000 construction jobs, and after opening is expected to create 2,500 permanent jobs (including employment by tenants).

If H.B. 1012, H.D. 1 were enacted, those REITs would be likely to modify their businesses to minimize double taxation and the anticipated Hawaii revenue, risking millions of dollars of capital investment and thousands of jobs. A new tax of 6.4% on net income in one state that does not exist in another state would encourage multi-state REITs to invest where the tax does not exist in order to maximize value to shareholders. The Department of Business, Economic Development and Tourism's (DBEDT) REIT study released in September 2016 specifically notes that its "estimates do not take into account how REITs would change their behavior if the DPD were repealed." For example, REITs may claim deductions or tax credits not currently claimed because currently the DPD fully offsets their income. At the same time, multi-state REITs likely would shift investments among the 48 states where double taxation is absent, and tax-exempt investors like pensions and endowments would fill the vacuum left by their departure and invest in more Hawaii real estate – resulting in no additional tax revenue for Hawaii.

H.B. 1012, H.D. 1 discourages investment in affordable housing. REITs with office buildings or retail properties in Hawaii currently are encouraged to build workforce housing so their tenants have places to live and shop. Limiting the DPD only to income from affordable housing lowers already low margins, discouraging further investment in affordable housing. Investors would view 15 years as permanent, and would shift capital to states without double taxation. In fact, we understand that at least one large REIT declined to invest in a sizable Hawaii project due to the mere threat of this legislation.

REITs are good for Hawaii: NAREIT urges this Committee to hold H.B. 1012, H.D. 1. Even though H.B. 1012, H.D. 1 purports to suspend the DPD temporarily (for 15 years) and exempt certain "affordable housing," its enactment would be tantamount to repeal. Except for New Hampshire, every other state that imposes a corporate-level income tax allows the DPD for widely-held REITs. Accordingly, NAREIT urges this Committee to hold H.B. 1012, H.D. 1.

To learn more about REITs in Hawaii, see NAREIT's www.theREITwayHawaii.com.