WRITTEN TESTIMONY OF

DARA F. BERNSTEIN
SENIOR VICE PRESIDENT & TAX COUNSEL
NAREIT
IN OPPOSITION TO H.B. 475

BEFORE THE HAWAII HOUSE
COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS

THE HONORABLE ANGUS L.K. McKELVEY, CHAIR
THE HONORABLE LISA KITAGAWA, VICE CHAIR

HEARING ON H.B. 475

JANUARY 30, 2019

Nareit appreciates the opportunity to submit testimony in opposition to HB 475. My name is Dara F. Bernstein, and I am submitting this testimony on behalf of the Hawai‘i members of Nareit. Nareit is the worldwide representative voice for real estate investment trusts—REITs—and publicly traded real estate companies with an interest in U.S. real estate and capital markets. These real estate investment trusts, which have substantial long-term investments in Hawai‘i, strongly oppose, and ask you to hold, this measure.

Congress created REITs in 1960 to give all Americans the chance to invest in large-scale, income-producing real estate beyond just their homes. REITs now operate in all 50 states and the REIT model has been adopted by more than 35 countries and regions throughout the world.

It is important to note that REITs must meet a number of requirements that other Hawai‘i-based and out-of-state real estate businesses need not. These requirements ensure that REITs are widely-held, long term investors in real estate.

For example, and most importantly, while other businesses can keep their earnings and reinvest them; REITs cannot. Instead, REITs must distribute their taxable income, and the income is taxed by the state where the shareholders reside. In exchange for distributing all of their income – and for meeting other asset, income and operational tests, REITs can claim a deduction for dividends paid (DPD). REITs can retain up to 10% of taxable income (for example, during a recession) but must pay corporate tax on what they retain. Even though REITs are subject to requirements that other businesses are not, HB 475 would eliminate the REIT DPD.

Also, unlike other real estate businesses, REITs cannot engage in “flipping” properties – any gain from doing so is subject to a 100% tax. REITs are long-term neighbors in this community. The conflation of REITs with the activities in Kakaako suggests that the nature of REITs is not fully understood. REITs hold their investments for a very long time. These entities are not making a quick profit and leaving town; they are making long-term real investments back into the community and improving the State’s retail, office, hotel, affordable rentals, and medical facilities.

Further, unlike other real estate businesses, REITs must be widely held, and their shares must be freely transferable. Unlike partnerships and S corporations, REITs can’t pass through losses to investors. Also unlike partnerships and S corporations, many REITs are publicly traded and thus subject to securities laws requiring public disclosure. Many mutual funds (with individual owners) and retirement plans (with individual beneficiaries) invest in REIT stock, and a number of Hawai‘i-based firms invest in REITs.

In addition, several local investment firms which manage investments for their clients hold millions of dollars in REIT stocks. The chilling effect of this measure would cause such local investors to avoid investment in REITs with Hawai‘i interests if Hawai‘i REIT investment is taxed differently from REIT investment virtually anywhere else.

HB 475 is contrary to federal income tax rules and the existing laws of virtually every other state with an income-based corporate tax system. Enacting this proposal would double tax REITs and, most negatively, signal Hawai‘i’s discouragement of long-term capital investment in the State. 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.

On a personal level, Hawai‘i residents have benefitted from REIT investment, which made possible dining at the Cheesecake Factory at Ka Makana Ali’i or taking their family to Wet'n'Wild or going shopping at Pearlridge, more eating choices and better Waikiki parking opportunities with the re-development of the International Market Place, not to mention the financial benefits to the Queens Health System, which is the landowner.

Hawai‘i’s significant economic growth over the past several years is, and we hope into the future, will be, a direct result of REIT investment. The popular new addition to Ala Moana Center was made possible by REIT funding. That project alone was estimated to have brought in more than $146 million in state revenue in 2016. Since completion, the additional retail sales produced some estimated $33 million in GET revenue for the state, along with 3,000 new jobs.

REITs provide sorely needed investment capital to Hawai‘i. If this measure is passed it is very likely that REITs will choose to deploy their capital elsewhere; Hawai‘i will be on the outside looking in.

These jobs and tax revenue would not be here without REIT funding. REIT investment occurred during the recession we recently experienced. While regular investors shied away from re-development, REITs continued to build and improve their properties, providing a boost to the State’s local economy through needed construction jobs and later retail jobs for the completed projects.

Real estate projects funded by REITs are creating affordable rental housing, including Moanalua Hillside Apartments in Aiea and the new student housing at UH Manoa. REITs also provide office space for small businesses that employ thousands of local residents. Medical facilities made possible by REITs, like Hale Pawa‘a, also ensure Hawai‘i physicians can deliver the highest quality care in state-of-the-art facilities.

While REITs in Hawai‘i have been good for the local economy, they have also supported a wide variety of non-profit organizations providing much-needed services throughout the state. For example, Washington Prime Group’s Pearlridge Center has partnered with the Honolulu Chapter of the American Institute of Architects to support the “Canstruction” project. Over the past 13 years, more than 377,042 pounds of food has been raised through this event to help feed the hungry in Hawai‘i – providing more than 296,884 meals.

Considering the many problems with the provisions of this measure and the likelihood for real economic harm that could result, if it were to pass, the Hawai‘i members of Nareit respectfully ask that you hold this bill.

Thank you for the opportunity to submit testimony on this measure.