SanHi
GOVERNMENT STRATEGIES
A LIMITED LIABILITY LAW PARTNERSHIP

DATE: February 7, 2018

TO: Representative Sylvia Luke
Chair, Committee on Finance
Submitted Via Capitol Website

RE: **H.B. 2702 – Relating to Taxation**
Hearing Date: Thursday, February 8, 2018 at 2:00 p.m.
Conference Room: 308

Dear Chair Luke and Members of the Committee on Finance:

My name is Rick Tsujimura and I am testifying on behalf of the Hawaii 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 Hawaii, strongly oppose this measure.

House Bill 2702 proposes an unworkable system. Unlike an S corporation, a publicly traded REIT is not limited to 100 shareholders who can be easily identified. In fact, many such REITs have millions of shares outstanding, with approximately 99 percent held in "street name" by a central securities depository on behalf of the ultimate owners.

It is and would be impossible for a given REIT to provide the name, address and federal identifying information required under House Bill 2702 with respect to all of these shares. And the way in which capital markets operate, with thousands of shareholders entering and leaving the market in a single day or an hour, further compounds an already impossible challenge.

There are also likely federal constitutional issues, with regard to jurisdiction and tax credits in shareholder residence states that could take years to sort out. In particular, a shareholder in a publicly traded REIT (just like a shareholder in any other publicly traded company) generally has no involvement with the business of the REIT, which may take place in any number of states and/or countries. Imposing state income tax on the passive investor merely because the underlying REIT invests in a particular state raises U.S. constitutional questions whether, among other things, the "purposefulness" of the shareholder's contact with the State is sufficient to satisfy constitutional requirements. Sorting out potential constitutional challenges could take time and be burdensome on the state.

Just as a small example, a local investment firm, founded in the late 70s originally to manage the pension funds of a small local institution holds millions of dollars in REIT

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stocks, none of which own projects in Hawaii, and REIT shares in mutual funds sponsored by Vanguard and Schwab, which may or may not have an interest in Hawaii projects. The chilling effect of this measure would cause such local investors to avoid investment in REITs with Hawaii interests if all of their dividends were withheld pending an investigation into how much of those dividends were in fact derived from Hawaii REIT projects.

This chilling effect will not only impact REITs but also other outside investment.

There are many incorrect assumptions and false claims surrounding REITs premised upon the recent federal tax reform act. The most recent is the assertion that REITs should pay more in taxes because they received big deductions in the recently enacted tax reform legislation. In fact, the new law made no specific changes to the REIT rules. As in the past, all REIT profit, whether in Hawaii or elsewhere, must be distributed to shareholders to be taxed as shareholder dividend income by the IRS and states like Hawaii that have state income taxes. Conflating the corporate tax changes applicable to non-REITs with REIT operations to somehow suggest that REITs benefitted inappropriately is fundamentally false and misleading.

On a personal level, Hawaii 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 Pearl Ridge. More eating choices and better Waikiki parking opportunities with the re-development of the International Marketplace, not to mention the financial benefits to the Queens Health System, which is the landowner.

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

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 our 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 Pawaʻa, also ensure Hawaii physicians can deliver the highest quality care in state-of-the-art facilities.

While REITs in Hawaii 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, the REIT that financed Ka Makana Ali'i committed $1 million dollars to support social services and community programs that improve the quality of life for local residents. REITs also are an essential component of pension investments of Hawaiian Airlines, the Queen's Health Systems, the Clarence T.C. Ching Foundation and the Hawaii Community Foundation, as well as the investment portfolios managed by Hawaii's two largest banks, First Hawaiian and Bank of Hawaii.

REITs are long-term neighbors in this community. By law they cannot engage in flipping properties. 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. Ala Moana has been held by GGP for a very long time. Taubman's interest in the International Marketplace will be for a long time. Douglas Emmett holds office buildings downtown for a long time. These entities are not making a quick profit and leaving town; they are making real investments back into our community and improving our retail, office, hotel, affordable rentals, and medical facilities.

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 Hawaii members of Nareit respectfully ask that you hold this bill.

Thank you for the opportunity to testify on this measure.