

## **EDB Committee**

---

**From:** Tom Croly <TCroly@maui.net>  
**Sent:** Tuesday, October 15, 2019 12:17 PM  
**To:** EDB Committee  
**Cc:** Kelly King; Keani N. Rawlins; Tasha A. Kama; Riki Hokama; Alice L. Lee; Mike J. Molina; Tamara A. Paltin; Shane M. Sinenci; Yukilei Sugimura  
**Subject:** Testimony for EDB-37

Please accept this email as my personal testimony for EB-37 County Property tax reform.

I do not believe that i will be able to attend the next meeting on Thursday, but I would be happy to answer any questions about this testimony.

Tom Croly

# **Real Property tax Tax reform**

I have long felt that Maui's Real property tax code has been in need of reform. As I have studied the code, I have found that it is inconsistently applied and is often not clear. One example is that some Maui homeowners are granted more than one homeowner exemption on the same property. While other homeowners are unjustly denied their homeowner exemptions and tax rate. Therefore, I was excited to see this Council take on the task of reforming the code. I have read the report from the temporary investigative group, watched the two committee meetings and carefully considered the proposed changes to code presented at the October 3rd Budget committee meeting. I offer the following comments to assist in the vetting process of these proposed changes.

### **Purpose and Intent**

I feel that it is imperative that the Council first make clear the purpose and intent for its reform of the tax code. Any and all changes proposed should clearly state how this change would advance a policy objective that the Council may want to support and why. For example: the tiered rates may seek to advance a policy of supporting affordable housing by creating a lower tax burden on lower value owner occupied homes. Such a policy statement may call into question why tiered rates should be applied to commercial or short term rental properties. Nevertheless, each proposed change should be documented with Council's intent for making the change.

Creating classifications based on uses rather than zoning is fine, as long as all property owners in the designated class have the same allowable uses. Classification by zoning is the typical way that this is accomplished. Maui county used to classify exclusively by zoning districts, but thru the years has gotten further and further away from this. A review of Maui's tax rates and classifications may be helpful to better understand the current classifications and associated tax rates.

### **History of Maui County tax rates and classifications**

Prior to 1982, the State set the tax rates by County. All land and buildings were taxed uniformly at a single tax rate based on the County that land was in. Zoning and uses were not a factor in the tax rate that was applied. When each individual County took over the Real property taxation in FY1982, this policy of equal taxation was maintained by Maui County, but

Honolulu established 2 rates, one that applied to properties used for residential purposes and one that applied for properties for commercial properties.

In 1985, Maui County followed the lead of Honolulu and established three different tax rates, a \$4.75 rate that applied to residential and agricultural districts, a \$6.00 rate that applied to Commercial and industrial districts and a \$7.00 rate that applied to hotel and apartment districts. The next year, the apartment rate was reduced to \$4.75, to be consistent with the other residential use districts. These classifications and rates remained stable until 1989, when the hotel rate was increased to \$8.00.

In 1993, thru ordinances 2199 and 2130, the County of Maui established the Homeowner classification and the condominium declaration of use classifications. With the exception of unimproved residential, this was the first time that the property's tax classification was based on something other than strictly the district (zoning) of the property. Instead the homeowner tax classification was based on meeting specific resident requirements and the actual use being made of the property. The homeowner classification was provided with a lower, \$3.50 tax rate. And the Condominium self-declaration was based on the property owner specifying the actual use he was making of his condo unit. And this is where the inconsistencies in application of the code began.

The condominium declaration hoped to capture short term rental uses legally taking place in the apartment district and separate them from long term residential uses and second home uses. This self-declaration of use was not always accurate. And declaration of homeowner uses were also not always truthful. But the tax department has implemented various policies thru the years to improve the accuracy of these declared uses.

The tax rates established in 1989 and the homeowner rate established in 1993 remained consistent until 1999 when all rates were increased across the board by 6%. Later a 2% across the board decrease of all tax rates was implemented in 2000, but the relationship between all the rate classifications was consistently maintained from 1989 to 2003 when apartment and residential rates were increased by 19% creating a greater rate disparity between homeowner and other residential uses.

These rates remained relatively stable until 2005 when a \$14.00 rate was established for the new "timeshare" classification. And in 2006 the homeowner rate was dropped from \$3.50 to \$2.50 and in 2007 to \$2.00. Additionally the homeowner exemption was incrementally increased from \$50,000 to \$300,000 during this period of time creating an even greater tax disparity between homeowner and other residential uses. These changes established a policy that resulted in Maui having the lowest tax rates in the Country for owner occupied properties. And it extended these low rates and exemptions to several businesses where the owner also resided.

From 2006 thru 2010 rates were decreased in all classes except hotel and timeshare, primarily to compensate for the rapid increase in property values that took place in the mid 2000's. This decrease in rates of non visitor related properties and Maui's rapid population increase with new residents taking advantage of low homeowner rates and generous exemption has further shifted Maui's real property tax burden to the visitor related properties.

In 2010 the Commercialized Residential tax classification was created. This tax class was created specifically for those Maui homeowners who applied for and were granted Bed and Breakfast permits that allowed these resident homeowners the right to use a portion of their homes to accommodate visitors. The rate set for this classification has tried to recognize both the homeowner and visitor accommodation aspects of this mixed use of the property.

From 2011 thru 2018 the tax rates in all classifications were adjusted proportionally to offset the increase or decrease in assessed values in each individual tax classification, implementing a policy designed to neutralize any large swings in property values. This resulted in the rates of some classifications, that had traditionally been the same, like commercial and industrial, to vary from each other. But was not actually a change in tax policy.

In 2018, a tax classification called Short Term Rental was established and broke away individually owned apartment units used for short term rental and hotel zoned properties from true hotel and resort properties. This new tax

classification now clearly identified that it is the individually owned condos and short term rental home permit holders who collectively are the largest taxpayers of Maui County. While this had long been the case, when these properties were included in the same tax classifications as true hotels, it appeared that Maui's hotels were the foundation of Maui's tax base. But the fact is that the individually owned short term rentals are generating more than three times the amount of taxes generated by the hotels despite many more visitors staying in hotels vs. short term rentals.

In 2019 the real property tax load carried by the short term rental tax classification was increased by an additional \$22 million and the hotel classification by \$10.6 million further increasing the tax burden borne by the visitor accommodations vs. Resident population to more than 5 to 1. This appears to be a policy decision, even if it has not been clearly stated in the code.

### **Clarity and Consistency**

Irrespective any policy decisions made by Council, Maui County Code should strive to be clear and consistent in its language and implementation. The code should not be left to interpretation. I feel that the current real property tax code is lacking in both of these regards. In the past, tax classifications did not matter as much as today because initially all tax classifications were taxed at the same rates. Therefore, what classification a property was placed in was irrelevant to the tax bill that the property received. And because all tax classifications were initially based on the zoning of the property, consistently was maintained. But thru the years, different rates were established for different tax classifications and some new classifications were established that were based on the use of the buildings on the land rather than the zoning of the land.

Many of the proposed tax classifications do not clearly align with zoning district designations. It should be made clear in the code, what classifications would be applied in any given zoning, provided one of the exceptions to zoning do not apply. For example, prior to any use being made, what tax classification should apply to vacant land; in the Hotel district, in the Apartment district, in the Rural District, in Residential districts, in the Interim district or in various project districts?

It also should be made clear when multiple exceptions to zoning classifications apply, which one would apply or better yet, how the property's valuation would be split and taxed in multiple classifications in the case of multiple uses taking place?

Every property owner should be able to read the tax classifications and be able to clearly determine what classification should apply to his/her property. The changes proposed seem to make this more difficult, rather than less difficult, to achieve. My first question for clarity is what properties are intended to be included in the non-owner occupied classification? The properties in this class are designated by exclusion rather than by positive affirmation. This designation by exclusion from other classifications causes confusion both for the property owner and for myself while serving on the Real property tax board of review.

Removal of the condominium classifications also removes the only clear "use" definitions in the tax code of the different uses. Letting condominium classifications be determined by "highest and best use" is both less clear and could result in unintended consequences. For example; owners of condominium units where short term rental is allowed by ordinance might decide to change the use of their unit from long term rental to short term rental, if their taxation is going to be at the higher short term rental rate. Or they may increase the rent to their tenant to make up for the doubling of their tax bill.

A suggestion that I have in this regard would be to send out a new self declaration form to all condo unit owners before the end of this year and include a designation for "part time second home use" and "long term rental use", in addition to the current choices of homeowner, short term rental and commercial, to determine how many properties in condominiums, where short term rental is allowed, are actually being rented to a Maui resident long term. I suggest that no classification change is made to the condominium self-declaration process, until the net effects of these classification changes have been carefully evaluated.

### **Mixed use Properties**

When properties are made up of a single dwelling unit or contain a use that fits a single classification, then proper classification should be possible. But many properties contain multiple uses and the code needs to be clear about how to classify in the case of multiple uses of the same parcel. For example, currently if a portion of a property is used as the primary home of the owner, the entire property is classified as homeowner and given a homeowner exemption and very favorable homeowner tax rate. This is currently being applied to properties in commercial zoning with large commercial business operating on the same parcel and as well to a hotel allowing for the use of 9 individual short term rental cottages on the same parcel.

Is it the Council's intent to allow an entire property to be designated "homeowner" irrespective of the types and magnitude of other uses taking place on the property? For example a 50 unit apartment building where the owner (or an owner) lives in one of the units, should that entire property be designated homeowner? I might suggest a new classification called multifamily residential to replace apartment, for properties where the individual tax key contains more than 3 dwellings.

Is the new classification of non-owner occupied, intended to over-ride zoning? And would it apply to properties with commercial uses also taking place?

### **Tiered rates**

The intent of having tiered tax rates in classifications other than homeowner should be made clear. In the homeowner tax classification the idea of tiered rates seems self explanatory, in that it would remove the tax benefit given to Maui homeowners, intended to offset the high costs of living in Maui, for higher valued properties where property owners are disproportionately benefiting from this tax reduction and where many of these property owners may not need such a benefit. But it is less clear why a larger commercial property, or an apartment complex with more apartment units would be taxed at a higher rate than a smaller property. Or why a higher value Short term rental should be taxed differently than a lower value short term rental. This might have the effect of incentivizing lower valued properties for short term rental.

A side effect of tiered rates in classifications other than homeowner may be more condominiumization, where the same owner would own all condo units. By dividing a larger parcel into multiple condo units, each unit would have a lower assessed value than the whole. The result would be that each unit would be taxed at a lower rate since its assessed value is lower and would not trigger the next taxation tier.

### **Illegal uses**

The Real property tax department has stated that it cannot tax illegal uses. But it seems unfair that most illegal short term rental uses are currently being made by Maui residents living in their homes and benefiting from a homeowner exemption. Reform of tax code should at least attempt to rectify this inequity by calling for the removal of any homeowner exemption if the property owner is found to be making any unpermitted short term rental uses on their property without a permit.

### **Legal grandfathered short term rental uses**

Some properties have been granted the right to make short term rental uses because of grandfathering or apartment zoning with buildings built prior to 1989. Many of these properties are not currently classified as short term rental, because no effort has been made to document the uses of these properties where short term rental use may be made without a permit and where the property has not been condominiumized.

### **Recommendations**

This tax reform effort needs more consideration and to be thoroughly researched before informed policy making decisions should be brought to a vote. This effort falls far short of being called reform, as it only deals with tax classifications and establishes a tiered tax structure. It has not addressed any of the inequities that I have noted in the current system and has not even touched on assessments (specifically how hotel properties are assessed) or agricultural

assessments for lands used in active agriculture. And it has not clearly established how to equitably treat properties where multiple uses occur on the same parcel.

My recommendation for the committee is that they only pass setting up tiered property tax rates for the homeowner and residential tax classifications and that they leave all the current tax classifications alone for this year. Send out a "declarations of use" survey to all properties in the county to get a better idea of the actual uses taking place on all parcels in the county. Such a declaration can also be used to help educate the public about allowable uses on their properties. Study of the current declared uses could be helpful in setting up a taxation strategy next year that may lead to a tax incentive for creating more long-term rentals.

The other recommendation I have that is not considered in the current proposed legislation is that I believe all land in the county should be classified for real property tax based on its zoning. Because it is the zoning that determines what may be built on the land and how intensive the development of the land may be. The buildings on that land should be classified and taxed based on their actual use. This would result in every property having two tax classifications. One that applies to land and one that applies to buildings.

This strategy would represent the proper application of the term "highest and best use." Because what is meant by the highest use, is what may be built on the land. Then classifying actual use of the buildings is a more consistent way to tax the actual impacts of the use being made. The most valuable land in Maui County is hotel zoned land because it can be intensely developed with many visitor dwelling units and much commercial enterprise. But agricultural land must be used primarily for agriculture and should never be taxed like a hotel, even if there is a building located on the land that may be used as a visitor unit. That building can and perhaps should be taxed as a hotel, but the land should never be. I believe that such a framework for real property tax classifications would be more fair and would allow for more consistent taxation. But the department is currently not set up to implement such a structure today.