Harry Kim
Mayor

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2019 OCT 31 AM 9: 24
COUNTY CLERK
COUNTY OF HAWAII

TO: Aaron Chung, Council Chair

FROM: Deanna Sako

DATE: October 31, 2019

Attached is our final Real Property Tax Review Working Group and Ag Committee report which includes recommended changes to the County Code.

If there are any questions, please contact Lisa Miura at 961-8260.

Comm. No. 90.1
Ref. To: FC
Ref. Date ~~OCT 31 2019~~

Harry Kim
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County of Hawai`i
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FINAL REPORT TO HAWAI`I COUNTY COUNCIL FROM THE REAL PROPERTY TAX REVIEW WORKING GROUP AND AGRICULTURAL COMMITTEE

September 20, 2019

This is the final report to the Hawai`i County Council from the Real Property Tax Review Working Group (Review Group) which includes the Agricultural Committee (Ag Committee). The Review Group held twenty-four meetings and the Ag Committee held twenty-three meetings.

The focus of the Review Group and Ag Committee was to review and give policy driven recommendations as needed on the following: Hawai`i County Code Chapter 19, Finance Director Rules and Regulations as it pertains to Real Property Tax, Agricultural Rates/Values, 2011 International Association of Assessing Officers (IAAO) Audit and review proposed changes or legislation which affects the Real Property Tax Division that is referred by the Council or County. In addition the Real Property Tax Division has been providing the Review Group and Ag Committee with complaints and concerns the Division receives.

The group has met since August 2017, and had agreed to meet for a period of two years. Reports were filed to provide County Council with updates of the group's progress. The goals were collectively agreed upon:

- Increase the fairness of the County's Real Property Tax Program
- Identify and incorporate best property tax administrative practices
- Propose additional tax programs as appropriate
- Identify public policy goals and incorporate them into the County's Real Property Tax Program

While tax rates were not part of the group's tasks, they were an integral part of discussion. The group wishes to recognize that Council and Administration are not looking to the group to provide insight into specific rates and tax rates are to be evaluated separately by Council and Administration through the annual budget process. As such, we are not recommending any changes to tax rates.

Going forward, the Review Group recommends the continuation of its participation as an Advisory group to maintain the informal nature of the review of the Real Property Tax

Program and provide guidance to the Division. The Review Group further recommends the meetings to be held on a quarterly basis or as needed to ensure continuity and momentum.

In regard to the prior recommendations provided previously in reports to County Council, the Review Group is aware Corporation Counsel has provided ordinance changes to the Department of Finance Administration. With the busy fiscal year end and budget complete for 2019-2020, we are hopeful Administration will submit the recommended changes to the County Council or County Council will introduce legislation in time to be effective within the next tax year 2020-2021.

The prior recommendations provided previously by the Review Group include the following:

1. **The Veterans Disability Exemption annual real property tax to be $0.** This would require a change to the Hawai`i County Code. Recommendation is to change for tax year 2018, however, it may be more realistic to have this done for tax year 2019 due to budget deadlines. To receive this benefit, the current program requires the Veteran be 100% disabled due to a service related injury and the property needs to be the Veteran's primary residence. This program currently has 609 parcels and at the current $200 minimum tax, the County receives $121,800 in revenue annually. There was much discussion regarding the value of the properties in this category, the potential increase in properties that could end up qualifying for this substantial discount and the concern with the loss of revenue during a time when the County is having difficulty balancing the budget. The consensus is these are 100% disabled Veterans due to a service related injury and they have already paid the ultimate price.

   Update: Bill No. 165 introduced by CM Dru Kanuha was passed, Ordinance 18-88 became effective July 1, 2019 resulting in the reduction of the minimum tax to fifty percent for the Veteran's Disability Exemption.

2. **Repeal the Non Speculative Residential Use program.** Recommendation for Administration or County Council to look into an ordinance to change the Hawai`i County Code. Recommended steps include informing all owners currently with parcels in this program of the repeal for tax year 2019, allow all parcels currently in this program to automatically convert these parcels to the Homeowner Exemption program (by virtue of the program they already technically are part of the Homeowner class) at the 2019 frozen value and explain the 3% CAP would then be applied to the tax year 2020 (first year they would see the increase). This has been a recommendation the Real Property Tax Board of Review has reported for several years as this program does not allow new applicants into this program therefore it is not considered to be fair and equitable. It is our understanding when the County Council approved the 3% CAP and the additional 20% homeowner exemption (up to $80,000) there was discussion to have this program completely repealed however it ended up being an "optional out" for those in the program. There are currently 483 parcels in this program. The impact to the real property tax revenue in tax year 2020 based on the current frozen non spec values would be

$23,000 total. In addition, the County will save approximately $4,400 per year in staff time which was allocated to the administering of this program.

Update: Corporation Counsel provided ordinance changes to the Department of Finance Administration. Currently pending administrative review and submission to County Council.

3. **Repeal Solar Water Heater Tax Credit.** This would require a change to the Hawai`i County Code. Recommendation is to completely repeal Section 19-104 of the Hawai`i County Code. In 2008 when this credit was established, the County of Hawai`i Building Code did not require solar water heaters, however, since 2012 it has been a requirement for all new construction. The group researched the possibility of creating a photovoltaic credit. As the Real Property Tax Division does not assess for solar and photovoltaic for residential use, there is no recommendation to create another program in the place of ending the solar water heater tax credit.

   Update: Corporation Counsel provided ordinance changes to the Department of Finance Administration. Currently pending administrative review and submission to County Council.

4. **Procedural change to Real Property Tax classification.** This would not require a change to the Hawai`i County Code, however, the group was approached by the Real Property Tax Division for guidance regarding a portion of the Hawai`i County Code that was not consistently applied on the island. There are properties under one acre of land that have been receiving the agricultural class tax rate when the highest and best use is residential. Three meetings were held regarding discussion of what would be the most fair and equitable way to tax these parcels as the underlying zoning is agricultural which included reviewing properties up to five acres in size. The recommendation to the Real Property Tax Division is all properties less than one acre in size which are not part of an agricultural use or dedicated agricultural use program should be taxed at the residential class tax rate to be consistent with the County Code island-wide. This is consistent with State Land Use Commission statute which provides for the construction of single-family dwellings on lots existing before June 4, 1976.

   There are currently 19,604 parcels which will experience a tax class rate change. 6,665 will experience an increase in taxes with the remaining parcels not anticipated to be impacted by the recommendation. The impact to the real property tax revenue in tax year 2019 based on the current assessed values and tax rates would be an estimated $1.3 million increase. Taxpayers still retain the option to apply for an agricultural use program to receive the agricultural tax classification in future years.

   Update: Real Property Tax Division implemented the procedural changes for Tax Year 2019 with notification issued to the owners of affected properties.

In addition to the prior recommendations, the Review Group is also recommending the following:

1. **Recommendation to maintain the current tax classifications based on highest and best use.** After many meetings, including presentations from the County of Hawai`i Planning Department and review of other local government tax codes, the Review Group is recommending to maintain the current tax classifications at this time. This decision, in the context of Short Term Vacation Rentals (STVR) and the apartment classification, was not made lightly and is based on several important factors including:
    a. The current Hawai`i County Code tax classifications are based on highest and best use.
    b. The County of Hawai`i Planning Department only requires certificates for STVRs which are non-hosted properties for rentals under thirty days. This differs from the State of Hawai`i and County of Hawai`i Real Property Tax Division as both reflect vacation rentals as anything under six months (or 180 days) whether it is hosted or not.
    c. There are additional burdens this Division would incur. The management of constant changes in actual use with no additional support staff would likely result in greater levels of inequity in assessments. An example would be the evolution of an STVR which can change within a relatively short period of time from hotel/resort classification into a proposed vacation rental tax classification, and back to hotel/resort classification. In addition, there is no reliable mechanism in place to provide data on these changes as they occur which would present administrative challenges.
    d. With the exception of County of Kauai and County of Maui, the County of Hawai`i Real Property Tax Division staff were unable to locate another jurisdiction within the country which had a vacation rental tax classification/rate for real property taxes.
    e. There are implications of moving STVRs to the hotel/resort classification from the apartment classification. During the analysis, it should be noted that based on current tax rates the hotel/resort classification is often lower than the current apartment classification based on highest and best use.
    f. Upon review of the apartment classification, which includes condominiums and apartments, the group identified the Affordable Rental Housing Program as an alternative mechanism to separate apartments from condominiums. The Affordable Rental Housing Program provides for a preferential tax rate upon affirmation of rental rates at affordable levels. Changes are to occur to allow for a focused communication to educate apartment owners of the Affordable Rental Housing Program in an effort to change this through internal procedure.

2. **Update the Affordable Rental Housing Program.** Update the portion of the Hawai`i County Code to reflect requested changes discussed in 2015 and 2016. During that period there were five meetings between County staff and local property

management companies which took into account requests from the public. These changes include:

a. Adding flexibility to allow for the use of a certification of rental rate in lieu of a current rental agreement.
b. Allowing a licensed property manager or authorized representative to sign the affordable rental housing claim form in lieu of an owner's signature.
c. General housekeeping of the County Code to provide for the consolidation or change to the placement of existing language.

These changes do not reflect the inequity between West Hawai`i and East Hawai`i rental amounts as this group understands this has to be handled at the Office of Housing and Community Development level due to their relationship with the U.S. Department of Housing and Urban Development (HUD).

In addition, the group is recommending a change to Section 19-2 of the Hawai`i County Code to remove the specified seventy-five percent of the payment standards as established by the Office of Housing and Community Development and replace with broader language to allow for flexibility to change the percentage through an administrative review process. Working in consort with other agencies, including the Office of Housing and Community Development, an administrative review of the percentage on a regular basis would provide for greater flexibility to react to changing market conditions. This recommendation is provided with the understanding that the Affordable Rental Housing Program is not a significant driver of encouraging affordable rentals alone, but is complimentary to other programs and should not be considered a stand-alone program.

3. **Update the Hawai`i County Code to appeal on total value for condominium properties only.** The assessment notice can continue to reflect land and building values separately.

   The Review Group did consider the request for all property types to appeal on total value only, however, the Review Group as a whole decided against this recommendation as it could cause more confusion and create more inconsistency. There was not enough data provided to the Review Group to change anything more than the condominium properties only.

4. **Allow for the use of Electronic Signatures**. In recognition of advancements in technology and opportunities to improve filing options for taxpayers, streamlining processes and recordkeeping, the Review Group is recommending a change in practice to allow for the use of electronic signatures in addition to the current process of filing for exemptions and program applications. The current process requires a hard copy, wet-signature for all exemption and program applications. The Division is currently in the process of converting forms into fillable pdfs and this recommendation is an extension of the Division's efforts to modernize its processes. Some of these processes would require corporation counsel consult or in the case of distributing assessment notices electronically, a change to the Hawai`i County Code.

The Review Group has also reviewed and affirmed the following items throughout the course of the last two years:

1. The proactive communication established by the Division notifying owners of agricultural to residential classification changes in February 2019. The Division issued more than 6,800 letters prior to the 2019 assessment notice notifying taxpayers of a change to their tax classification from agricultural to residential. This resulted in a greater level of communication between taxpayers and the Division to ensure all parties understood the reasoning and impacts of the change.

2. The Division's swift response to the Lower East Rift Zone Eruption which started in May 2018. The Division issued a significant number of damage assessment letters; coordinated assessments with Civil Defense, Office of Housing and Community Development; adjusted taxes as a result of the Mayor's emergency declaration; and revaluated the market's response and recovery in a very short period of time.

3. A continuous review of State and County legislation impacting real property taxation.

4. The evaluation of the Tax Board of Review's annual report and recommendations with some of these recommendations also being affirmed by the Review Working Group. An example was the affirmation and recommendation by the Review Working Group to repeal the Non Speculative Residential Use Program.

5. A review of 2012 IAAO Audit action items which the Division has implemented and others which require Council action.

Interim recommendations made by the group to Real Property Tax Division included presentations to the entire group by the Planning Department of the STVR bill and program, overall review of recent Legislative actions and a review of the County of Hawai`i budget cycle (*see Appendix A)* in relation to the Real Property Tax Division's tax cycle and various deadlines.

Accompanying this report, the Ag Committee is submitting a comprehensive recommendation to update the agricultural programs including updating agricultural values. The earliest these changes could have an impact on real property tax revenues is tax year 2021, if County Council is able to approve in a timely fashion. We realize these changes are substantial, however, the agricultural programs should provide considerable incentive to farm production at a community level and go beyond a personal sustainable level.

The current Agricultural Programs were developed at a time where there were large landowners with a single crop/agricultural activity such as ranching or sugar cultivation. The Dedicated Agricultural program was very effective in working within this set of circumstances. In addition, the Non-Dedicated Program supported small scale agricultural activities in the rural environment.

However, since the origination of these program, there has been structural changes within the agricultural industry and land development activities within the County. With the closing of the sugar plantations, large landowners have been seeking diversified agricultural activities on their lands. This has led to a program of leasing/licensing portions of properties to various farms, with the farming activities changing through time as markets change.

In addition, there has been a "gentrification" of the rural areas with the creation of "gentleperson" ranches. While supporting agricultural activities, the general tax breaks for non-dedicated agricultural activities has created an impression that the Agricultural Programs can be abused.

In order to support commercial agricultural activities as well as to continue encouraging reasonable agricultural uses within the rural areas, the Real Property Agricultural Committee has concluded that the overall agricultural tax program should be restructured with the creation of a three (3) tiered system. This proposed system would include:

- Revision of the existing Dedicated Agricultural Program to encourage its use by landowners within diversified agricultural activities;
- Creation of a new Short-Term Agricultural Dedication Program to encourage commercial agricultural activities where a farmer is just starting out or where the landowner is not willing/able to make a long term commitment for agricultural uses; and
- Revision of the Non-Dedicated Agricultural Program to continue to encourage agricultural activities in the rural areas while reducing the opportunities for and perceptions of abuse of the system.

These following recommendations must be considered in combination with each other as they would not achieve the appropriate goal without the other changes.

1. **Revise the 10 Year Dedicated Agricultural Program.** There are a number of reasons why the Dedicated Agricultural Program is not as effective as it can be in supporting commercial agricultural activities. A significant portion of these reasons will be addressed with the acceptance of the recommendations below. However, the program will also need to be revised to allow for diversified agricultural activities areas, recognizing that farmers and crops will change over time so area may be fallow while crops and/or farmers change. The potential for abuse of this program is proposed to be addressed with the requirement for a detailed farm plan that would identify the potential areas and types of uses as well as a requirement that any vacant areas be actively marketed during the dedication period. The program would also allow for blended agricultural values based on a potential range of uses. This would eliminate the need to continually monitor specific agricultural activities as long as the overall farm program is being followed. The valuation for this program would be the lower of 10% of market value or the dedicated value.

2. **Create a Short Term Dedicated AG program.** This would require a change to the Hawai`i County Code. The change would create a program similar to the 10 year dedicated program with a shorter term of 3 years. The requirements would be

identical to the 10 year program with the exception of it not being recorded with the Bureau of Conveyances. The program would be established to allow for diversified agricultural activities as provided in the Dedicated Agricultural Program. The valuation for this program would be the lower of 20% of market value or 3X the 10 year dedicated value. This program would be focused on start up operations or where there is uncertainty with respect to the long-term viability of a commercial agricultural program.

3. **Revise the Non-Dedicated Agricultural Program.** The Non-Dedicated Agricultural Program would be revised to require a minimum lot size for agricultural uses as set by the Dedicated and Short Term Dedicated Programs. In addition, in order to qualify for this program, a Farm Plan would be required to ensure there is a viable agricultural activity being undertaken. Another recommendation is that the Non-Dedicated property agricultural value would be based on a percentage of the Fair Market Value of the property and not as multiple of the Dedicated Agricultural rate. The agricultural value for this program would have an assessed land value of 30% of market value.

4. **Native Forest program.** Further review of the Native Forest program is recommended with input from local native forest practitioners, United States Department of Agriculture Forest Service Division, University of Hawai`i - Tropical Conservation Biology & Environmental Science and Tropical Ecosystem & Agroforestry Management staff. An updated value of the Native Forest program is suggested at ½ the current dedicated value per acre for pasture.

In addition to the recommendations above, the Real Property Agricultural Committee recommends to the County Council and Administration the following changes which are located in the Hawai`i County Code, Finance Director's Rules and Regulations as well as Real Property Tax office procedures and guidelines:

5. **Add a minimum size requirement for Non-Dedicated AG use parcels.** This would match the current minimum size requirements in place for the Dedicated AG program. There are approximately 3,000 of the 8,400 parcels currently enrolled in a Non-Dedicated AG program that would not meet the minimum size requirements. The county receives approximately $580,000 in revenue annually from these parcels and could gain approximately $6.5M by implementing an absolute minimum size requirement.

   The current minimum size levels are .25 acres (intensive AG), 1 acre (orchard), 5 acres (feed crops), and 10 acres (pasture). Parcels that fall below the minimum size may still be eligible to receive the Non-Dedicated AG benefit if they can prove they are part of a larger AG operation that in total meets the minimum size requirements or they provide additional documentation (i.e. Farm plan and/or schedule F, G-49).

6. **Reduce number of required signatures on AG applications.** The current county code requires all owners on title sign the application to receive the AG benefit. The

change would require at least 51% of the owners' signatures on each application including an affidavit of responsibility for any rollback taxes incurred. The group feels that requiring all signatures is prohibitive in some cases and should not be an excluding factor in the application process.

7. **Require specific documentation of commercial operations for Dedicated AG.** The change would require the submission of either the prior year IRS Schedule F or the State Department of Taxation Form G-49 upon application for the dedicated AG program. The group feels the current proof of commercial operations is not substantial enough to validate actual commercial operations.

8. **Create a blended AG value for Diversified Use.** This type of AG use will allow for a seamless transition between intensive agriculture and orchard without requiring a new application. The assessed value of this category would be midway between the intensive and orchard categories.

9. **Consolidate the pasture quality ratings to one value.** The current valuation for pasture is split between three categories. The current dedicated value for "good" pasture is $210 per acre, "average" pasture is $60 per acre, and "poor" pasture is $14 per acre. The group feels the variability of the carrying capacity is inconsistent to accurately assess pasture quality on an annual basis and would like to set one pasture value of $14 per acre for dedicated pasture lands.

10. **Require a farm plan with all AG applications.** The group feels the current application process does not adequately identify legitimate farming activities.

The current committee members for the Real Property Tax Review Working Group are:

Members from the general public:

Mary Begier, Mary Begier Realty (Hamakua, Hilo)
William Moore, William L Moore Planning (Islandwide)
Marissa Harman, Kamehameha Schools (Islandwide)
Nahua Guilloz, Parker Ranch (South Kohala, North Kohala, Hamakua, Kona)
Riley Smith, Lanihau Properties (South Kohala, Kona)
Shannon Matson, Hot Yoga Hilo (Hilo, Puna)
Stephanie Donoho, Kohala Coast Resort Association (South Kohala, Hamakua)
Peggy Farias, W.H. Shipman (Puna, Hilo)
Jaime Ortiz-Nava, Ortiz Hawai`i Real Estate Solutions LLC (Islandwide)

The Agricultural committee members for the Real Property Tax Review Working Group are:

Members from the general public:

Mary Begier, Mary Begier Realty (Hamakua, Hilo)
Chris English, Ponoholo Ranch (South Kohala, North Kohala, Hilo, Puna)
William Moore, William L Moore Planning (Islandwide)
Marissa Harman, Kamehameha Schools (Islandwide)

Nahua Guilloz, Parker Ranch (South Kohala, North Kohala, Hamakua, Kona)
Riley Smith, Lanihau Properties (South Kohala, Kona)
Peggy Farias, W.H. Shipman (Puna, Hilo)
Jaime Ortiz-Nava, Ortiz Hawai`i Real Estate Solutions LLC (Islandwide)

The following members from the County of Hawai`i support the efforts of the Real Property Tax Review Working Group and the Agricultural Committee:

Deanna Sako, Finance Director
Glenn Sako, Research & Development Ag Specialist*
Lisa Miura, Real Property Tax Administrator
Keita Jo, Acting Assistant Real Property Tax Administrator
Brandon Cain, Valuation Analyst

**Agricultural Committee only*

Sincerely,
Real Property Tax Review Working Group and Agricultural Committee

APPENDIX A

BUDGET CYCLE

Budget Cycle

- JAN 1: DATE OF ASSESSMENT
- JAN 11: 6 MO PROGRESS REPORT ON PROGRAM OBJECTIVES.
- STATE LEG. CONVENES 3RD WED IN JAN
- JAN: AMENDED SUPPL. BUDGET REQUEST DEADLINE

- FEB 20: 2ND ½ INSTALLMENT DUE

- MAR 1: MAYOR'S BUDGET TO COUNCIL ("DRAFT")
- MAR 15: ASSESSMENT NOTICES
- MAR: COUNCIL PUBLIC HEARING

- APR 9: APPEAL DEADLINE
- APR 10: AMENDED DEPT. BUDGET SUBMISSION DEADLINE.
- APR 19: RPT CERTIFICATION

- EARLY MAY: AJOURNMENT OF STATE LEGISLATURE
- MAY 5: AMENDED BUDGET TO COUNCIL (FINAL)
- MAY: FIRST READING

- JUN 20: TAX RATES SET
- JUN 30: COUNCIL ADOPTION OF BUDGET*
- JUN 30: CURRENT FISCAL YEAR ENDS
- JUN 30: EXEMPTION DEADLINE

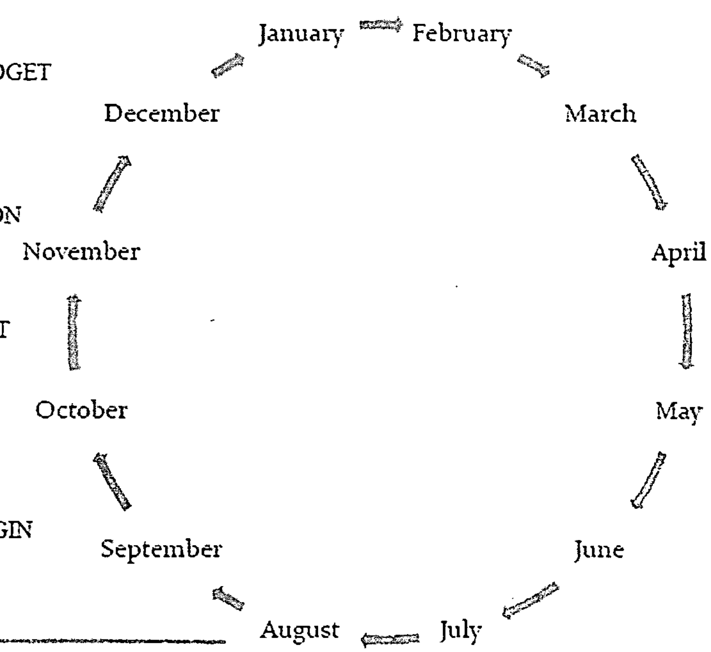
- JUL 1: NEW FISCAL YEAR BEGINS
- JUL 1: TAX CALCULATION & BILLING EXTRACT

- AUG 20: 1ST ½ INSTALLMENT DUE

- EARLY SEPT: INITIAL RPT ASSESSMENT & PROJECTIONS BEGIN
- SEPT: BUDGET KICK -OFF

- NOV 1: DEPT. BUDGET SUBMISSION DEADLINE
  - INCL. SUPPL. BUDGET REQUESTS
  - NEW EQUIPT PRIORITY LIST

- DEC 31: EXEMPTION DEADLINE
- DEC – JAN: DEPT. MTGS WITH BUDGET ADMIN.



*If council fails to adopt budget, Mayor's amended budget deemed adopted (if amended budget includes tax rate increases not approved by Council, prior submission without tax rate increase deemed adopted).

http://www.hawaiicounty.gov/finance-budget/