Hey, what's par on this hole?

Shooting for uniformity in golf course assessment

BY LAURENCE A. HIRSH

Golf course tax assessment has become a topic of increased interest since the New York State legislature considered allowing individual jurisdictions to base their assessments on highest and best use, rather than on continued present use.

While New York's assessment practice of valuation based on continued present use is somewhat unique, other jurisdictions also have specific assessment and valuation practices that compromise the concept of uniformity in golf property assessment.

This article discusses how a uniform methodology could be applied to the assessment of golf course and club properties across jurisdictional boundaries.

Background

In most jurisdictions, golf course and club properties are valued based on their highest and best use. While this is not an issue of valuation methodology, the requirement in any jurisdiction to estimate value based on highest and best use can create a tax burden on many golf courses that can ultimately put them out of business.

Many golf courses are on sites that could be more economically used for other purposes, such as residential or commercial development, if the zoning allows it and there are no restrictive covenants.

Because a golf course represents an inherently inefficient use of land resources, the value based on an alternative development is likely to be higher if such development meets the tests of highest and best use, including financial feasibility.

In New York state, case law originating in 1991 dictates that golf and country clubs (and other properties) be assessed based on their continued present use, rather than on a potential future use.

This is beneficial to the golf and country club industry and helps preserve open space and recreational opportunities in the community.

In most other states, while alternative potential preferential treatment is often available for these properties, it comes in the form of down-zoning, conservation easements, relinquishing of development rights, or agricultural designation, to name a few. In most (not all) cases, these restrictions can be permanent and lock the golf course

into either prolonged use (which may become economically unfeasible) or simply a ceasing of operations and an eventual eyesore.

Whether states and communities choose to assess based on highest and best use versus continued present use becomes a decision on whether tax dollars or open space and recreation are the priority.

Since many golf courses are on sites already restricted by zoning, restrictive covenants, or easements, those burdened by tax liabilities based on alternative uses are at a distinct disadvantage, especially when compared to municipal courses, which pay no real estate taxes.

Valuation

All real estate is assessed on the basis of market value, which is defined generally (the verbiage varies) as "the most probable selling price." Thus, market value presumes a sale of the property from a willing seller to a willing buyer, each well-informed and neither unusually motivated.

THE COST APPROACH

First and foremost, the presumption of a sale severely limits the usefulness of the cost approach to value because it does not reflect the actions of market participants.

Golf properties can no longer be considered "special-purpose properties that rarely trade in the market," as once described by both literature and some courts.

There are vibrant markets for daily-fee, semiprivate, and even not-for-profit private clubs. There are a wide variety of buyers ranging from large, multi-course management companies to individuals seeking entry into the golf business because of their love of the game.

Therefore, comparable sales exist on which to base a comparison.

THE SALES COMPARISON APPROACH

Long ago, the traditional method of applying the sales comparison approach to the valuation of golf courses was to employ a price-per-hole unit rate for comparison.

However, as the golf course market evolved, it became clear that the price-per-hole unit was misleading, if for no other reason that most golf courses have the same number of holes (18), and just about all have some factor of 9 (9, 18, 27, 36, 54, and so on).

Accordingly, buyers viewed these properties as income-producing investments and, even when there was no positive cash flow to capitalize, evaluated them based on gross revenue or cash flow multiples. These data can often be derived from golf course sale transactions.

Up-to-date appraisers now develop the sales comparison approach using market-derived (from sales) gross revenue multipliers (GRM) or capitalization rates (OAR). Even not-for-profit private clubs are valued this way because the vast majority of those sold are bought for income investment.

A weakness in the sales comparison approach occurs when sales or the subject are not stabilized, and adjustments become difficult because of the varying levels of stabilization. Typical adjustments to golf sales are often misleading.

Once these adjustments are completed, since golf course sales are typically sales of going concerns, with real property, personal property, and intangibles included, an allocation is necessary to develop the value of real property for tax assessment purposes.

THE INCOME APPROACH

The income approach is typically considered the best method for valuing golf properties and most reflective of buyer behavior.

There are several methods of developing the income approach for ad valorem tax assessment. In many cases these are dictated by the taxing jurisdiction, through historical case law, statute, or simply customary procedures in the jurisdiction.

Typically, the income approach is developed through the traditional methods of either direct capitalization of a stabilized income stream or yield capitalization (discounted cash flow) of a changing income stream.

This is somewhat complicated by the fact that golf courses generate revenue and expenses (golf carts, food and beverage, etc.) that are not attributable to the real property, and they are normally bought and sold as going concerns, including these items, which cannot be assessed as real estate.

Therefore, several methods have been developed for estimating value by the

income approach only for the real estate of golf course properties.

When the traditional methods of direct capitalization and discounted cash flow are developed, they are then subject to the application of an allocation process in several ways, none of which is considered particularly reliable.

The strength of the income approach is that it reflects the actions of market participants, while its weakness is that the allocation process is suspect because it does not reflect market actions.

Variations of the traditional methods are used in several states to parse out revenues and expenses from non-realty items like food and beverage, golf cart rentals, and pro shop sales, leaving a modified income and expense pro forma with revenues only from dues and fees and the corresponding expenses.

In some states, an estimated rental revenue is added back in for those areas to acknowledge that there is real estate involved there.

A third method is what's known as the market rent method, which has become popular in New York, based on case law emanating from decisions beginning in 2005 and now widely accepted in New York and in some other states.

The strength of the market rent method is the theory that leases of real property serve to isolate the income attributable to the real property, which can be capitalized into value for the real property only. The weaknesses of this method are:

- It does not reflect buyer and seller actions in the market.
- Its application in New York has used lease comparables from daily-fee and municipal courses to estimate rental rates and subsequent market value for private clubs.

Not only do private clubs and daily-fee courses differ in operating models, but also they exhibit significant real property differences in infrastructure, non-golf amenities, buildings, and course design. Daily-fee courses are typically designed for maximum play, and private clubs are designed for fewer, more skilled golfers, among numerous other differences,

The cost approach is typically not considered a reliable indicator of value. Rarely do buyers and sellers use it to evaluate their buy/sell decisions.

However, several states have case law that strongly suggests developing the cost approach, if for no other reason than to avoid having the appraisal disqualified.

As a golf course appraiser, consultant, broker, and advisor, I am most sensitive to the presumption of a sale that is inherent in the definition of market value dictating assessments in most states. Accordingly, I favor a valuation methodology that reflects the actions of market participants.

Today's market environment would indicate primary use of the income approach and supporting use of the sales comparison approach.

Consistent with buyers and sellers, the development of the income approach would be based on an analysis of revenues and expenses with net income (cash flow) capitalized at an appropriate, market-derived rate.

Since buyers in the current environment evaluate acquisitions on the basis of multiples of (both gross and net) revenues, the sales comparison approach reflects that by focusing on those multiples, most often the GRM because more data are typically available and many courses are not stabilized making an estimate of net revenue multipliers misleading.

Once these two indications of value are correlated into a final value conclusion, it is critical to understand that the value represents the going concern and not just real estate.

This is appropriate because it reflects how golf properties are bought and sold in the market, whereas the market rent approach previously mentioned is not typical of sale transactions and ignores the presumption of a sale inherent in the definition of market value.

Allocation of real and personal property

The final step in estimating the value of the real estate to be assessed is the allocation of real and personal property.

Among the most challenging issues in golf property valuation is the allocation of real and personal property.

Since almost all golf course transactions include significant personal property (including trade fixtures and intangible items), when the value of the real property is sought, as in tax assessment appeals and eminent domain cases (among others), an allocation of real and personal property is indicated.

Author David Lennhoff in "Separating the Real Property from the Tangible and Intangible Personalty in Appraisals "*The Practical Real Estate Lawyer*, November 2013) states,

> *Usually, estimated the value of real property is fairly straightforward. The appraiser capitalizes the rent for the real property, estimates a depreciated cost of the improvements and adds the site value, or makes a direct comparison to sales of similar real property. These are the three traditional approaches to value identified in nearly every real property appraisal text or course. Sometimes, however, the appraiser is not able to get directly to the real property rent or sales price. In these situations, the valuation of just the real property can get messy.*
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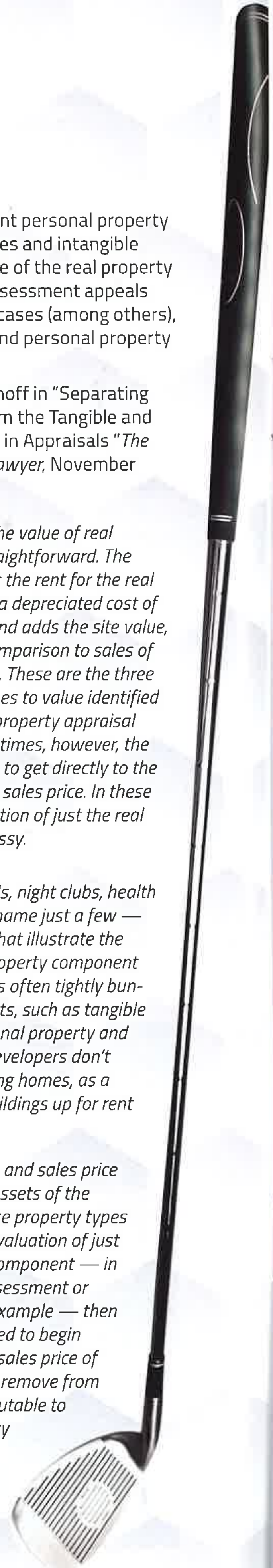
> *Hotels, regional malls, night clubs, health care facilities — to name just a few — are property types that illustrate the problem. The real property component of these properties is often tightly bundled with other assets, such as tangible and intangible personal property and monetary assets. Developers don't build hotels or nursing homes, as a rule, then put the buildings up for rent or sale.*
>
> *Instead, the revenue and sales price represent the total assets of the business. When these property types are the subject of a valuation of just their real property component — in real property tax assessment or condemnation, for example — then the appraiser is forced to begin with the revenue or sales price of the total assets and remove from it that portion attributable to the non-real property components. 'If only tangible assets are subject to property taxation,*



For more information and resources on the valuation of golf courses, check out the IAAO Library Subject Guide at www.iaao.org/subjectguides

then the value of monetary and intangible assets must be extracted as a first step.' The need to conduct an allocation is not subject to debate. How the allocation is accomplished, however, can be controversial.

Conclusion

In reviewing numerous articles advocating a variety of methods of allocation, I found that each has at least one "wrinkle." Therefore, it becomes incumbent upon the appraiser to tailor the analysis to the specific property being appraised.

My conclusions from this review include the following:

- Some methods are more reliable when estimating the real property value is more straightforward (unusual with golf properties), and others are more reliable when going concern value is more easily calculated.
- Tangible and intangible personal property should be addressed *separately* in order to achieve the most reliable and credible results.
- The cost new of most tangible personal property assets is typically going be the starting point for most allocation analyses.
- A detailed personal property appraisal should be obtained, but such a report is often neither available nor within the scope of most appraisal assignments.

While this article does not intend to "bless" a particular method of allocation, it is critical that the golf property be initially valued in a manner consistent with the actions of market participants in order to honor the presumption of a sale inherent in the term *market value*.

Thus, since golf properties are sold as going concerns, an allocation of real and personal property, using the approaches (income and sales comparison) that reflect market dynamics is appropriate.

Allocating real property value from the going concern value is therefore appropriate, rather than estimating market rental, which theoretically excludes personal property from the analysis and departs from a reflection of the market.

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