FEATURE

Golf Courses and Tax Assessments: Just One Right Way?

BY LAURENCE A. HIRSH, CRE

INTRODUCTION

There is no "one size fits all" approach to appraising golf course properties for ad valorem tax assessments. While this is acknowledged, there is concern about methodologies being employed that do not reflect the actions of market participants. The real problem inherent in the valuation of golf course properties for tax assessment cases is that there is a lack of consistency between jurisdictions in golf property valuation methodology. The purpose of this article is to provide guidance to attorneys, judges, assessors, appraisers and other interested parties on current practices in golf property valuation, and how best to achieve fair assessments based on methodology consistent with buyer and seller behavior for the particular property being considered.

As clearly illustrated in "Segmentation of Golf Course Markets" by Stephen F. Fanning,[1] there are several distinct types of golf course properties, with the primary areas being private, public daily fee and resort. Each requires consideration of different data sets to understand and value accurately, though in some states, courts have dictated that all courses (even private clubs) be considered as daily fee, regardless of whether the property in question is a private, membership club with entirely different economics and operations, and may even be part of a gated, private community that is not open to the public. Taking such an approach not only distorts the actual property characteristics, but further ignores the fact that private clubs can be and are operated for profit, despite the sometimes present myth that they cannot.

About the Author

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Following are some facts about golf properties:

- Private clubs, though often operated as *not-for-profit* are also very frequently acquired by investors and operated for investment income and growth;
- Private clubs and daily fee courses have very different operating profiles and require considerably different management techniques;

- The value of golf course properties is almost exclusively driven by their income-generating potential;
- Golf course properties are typically bought and sold as going concerns and for ad valorem tax purposes; an allocation between real and personal property is required.

When considering a valuation assignment for a golf course property, like any other appraisal assignment, it is necessary to consider the three traditional approaches to value.

INCOME APPROACH

Without question, the income approach is the method preferred by market participants. The income approach reflects the fact that golf courses are going concerns and that they are typically purchased for income investment. However, in tax assessment cases in many jurisdictions, valuations of golf courses are often forced into one type of operating scenario rather than acknowledging that there are several different types of operations, some of which are so dramatically different the only thing in common is that they are golf course facilities. As clearly noted in Fanning, there are multiple (as many as 12) types of golf courses and even five types of private clubs, each serving a different market segment and each targeting different clientele, often from different geographies.

For instance, many private golf and country clubs are member-owned and operated as not-for-profits. As such, it is not uncommon to hear the comment from clubs that "it can't have much value because it doesn't make any money." Conversely, taxing authorities claim that the only way to value such a "special purpose property" is by use of the cost approach. Neither of these arguments is correct.

In addition to the many not-for-profit clubs, there are also many private clubs operated for-profit by companies and individuals in business specifically for the purpose of owning and managing private clubs for investment and income. Many not-for-profit clubs have been sold to these operators in recent years as member/owners have demonstrated limited ability to keep their clubs afloat financially. While some have become semi-private, or even daily fee facilities, many have simply become for-profit, private clubs that are now profitable or are on their way to becoming profitable through professional management. Since most member-owned private clubs have an economic value to for-profit buyers, and there is clear evidence of a market for these properties, it is logical to value these clubs based on their for-profit potential and assume the property is operated accordingly. The likely buyers are for-profit buyers and unless the club's highest and best use is for an alternative development, using the private, for-profit value model is the best way to develop an accurate and reliable value estimate. This assumes, of course, that the club has profit potential. If it does not and there is no economically feasible use, the appraisal problem becomes more complex, which is discussed later.

Laymen seem more comfortable with the idea of daily fee courses (as opposed to private clubs) being valued by the income approach. Since most daily fee courses are operated for profit, that *seems* easier to understand. This can be misleading since some golf facilities are ill-suited for conversion (in the valuation exercise) from one type to the other. "Shoe horning" a private club into a daily fee valuation model ignores the fact that private clubs have economic value and their own unique marketplace. The models for a private club are as different as are the facilities, and the appraiser should take care to and be able to synchronize the valuation exercise to the specific type of property and the characteristics of that club. In those jurisdictions where this practice is preferred, it is recommended to value as BOTH a private club and a daily fee facility in order to illustrate the differences and the difficulty in being accurate while trying to "fit a square peg into a round hole."

Depending on market dynamics, course characteristics, and the size and quality of infrastructure and buildings, a golf property may be more suited to either private or daily fee use, making use as the other unlikely, or at the very least challenging and costly to adapt. And, there is the potential issue of memberships, the rights of members and refund obligations with private clubs that can result in a variety of legal issues, and may or may not contribute to the value of the real property depending on the type of membership contract and in which theory one believes.[2, 3] Many clubs have the element of membership deposit or initiation fee refunds as a liability; in many cases, the potential liabilities are complex enough to discourage buyers from even considering the purchase of clubs with those obligations on their balance sheet.

The income approach requires a deft understanding of the subject property, its relevant market characteristics and the ability to develop a value model consistent with the property and market. This can be accomplished through taking the time to fully comprehend the club's business model, its competitive environment, and the strengths and weaknesses of the specific club.

SALES COMPARISON APPROACH

The sales comparison approach is often applied by inexperienced golf course appraisers utilizing a unit of comparison of sale price per hole (dollars/hole). The problem is that the vast majority of golf courses are 18 holes, and the rest are some multiple of nine holes. Using this approach, the other elements of a golf course or club, such as the clubhouse, other sports amenities, infrastructure and economic characteristics, are ignored. There is no *common denominator.* Since almost all courses are purchased for economic reasons, even in the sales comparison approach, an economic unit of comparison such as a market extracted overall capitalization rate is appropriate. In the current environment, with many courses having limited or no cash flow, many buyers rely on gross revenue multiples (GRM) and typically have either a particular investment requirement, a minimum level of gross revenues, or both. It is critical to understand that GRMs vary with the level of profit (or loss) experienced, and can be misleading on non-stabilized properties.

In today's market, many sales are distressed, or at the very least not *stabilized,*[4] and often to varying degrees. This makes analysis difficult and executing a classic sales adjustment grid virtually meaningless. If one has a sampling of stabilized sales considered adequate, the sales comparison approach is quite useful. Typically, it is the approach used to test the reasonableness of the income approach, and the sales comparison approach is done more subjectively than objectively.

Many jurisdictions rely exclusively on the sales comparison approach despite its inherent weaknesses, yet often ignore its strong point, which is based on comparing the sales of different income streams.

Most experienced and qualified golf course appraisal specialists advocate developing the sales comparison approach, even if the market data is fragmented and doesn't show strong trends. At the very least, it illustrates what is occurring in the marketplace and can often be used as a check on the income approach.

COST APPROACH

Some say the cost approach is a test of feasibility. Others say the cost approach provides an estimate of land value. Still others claim that the cost approach is the only appropriate method of valuation for "special purpose" properties such as golf courses. The short response to the last of these claims is "Nonsense."

Without question, assessors are at a considerable disadvantage because of the sheer number of properties they have to assess and the limited amount of information they are provided. The simple fact remains that if the golf course or club is the highest and best use, the land value is not of particular importance in most cases. Feasibility is not usually an issue once the course is developed, and golf courses are not so "special purpose" that the other approaches cannot be developed. Most important, market participants completely disregard the cost approach. There is often considerable economic and functional obsolescence, which is very difficult to accurately measure; costs are difficult to estimate accurately and are not relevant to the value of an existing course.

In assessment cases, the cost approach is often used by taxing authorities because:

- it can be completed with limited market data;
- assessors have computer models set up to do the cost approach; and
- it typically yields the highest resulting value.

A big challenge in the cost approach today is that few golf courses are being built, so cost comps are more difficult to find. If accurate costs can be estimated, depreciation can be estimated by the market extraction method, and this approach can be done with some degree of reliability, however reliant on the accuracy of the other approaches it might be.

HIGHEST AND BEST USE

What if the club has limited or no profit potential and alternative uses are limited or not economically feasible? As a club, the value may be *intrinsic* to the membership but have limited *value in exchange.* If there is no development potential, the club ceases to operate and there is no economic use for the property, the appraisal problem becomes more challenging. Because the value of "open space" can be a real challenge, the cost approach is often employed by assessors but really doesn't provide a market-based indication of value. Sometimes, there are sales of conservation parcels that could be analyzed, but the question as to the economic value remains unanswered. This is a challenging appraisal problem that could be the topic of another article. One thing is for sure: the procedures relating to the broader issue of highest and best use vary from state to state, and care must be employed to ensure that the appraiser understands those issues and how they are impacted by the Uniform Standards of Professional Appraisal Practice and by local jurisdictions.

ALLOCATION

The issue of allocation of real and personal property value is one that has been debated by appraisers for a long time. For golf course properties, several methodologies exist, but there are no conclusive methods that adequately answer all the questions. The text *Analysis and Valuation of Golf Courses and Country Clubs* [5] offers allocation methodology ranging from the "excess profits" technique to the "management fee" technique, and others. Another technique that has been used recently is the "market rent" method, which converts golf course revenue sources into a rental rate for real estate only, which is then capitalized into a value conclusion. There is also the recent (2011) Appraisal Institute course on allocation that promotes a technique utilizing balance sheet assets and the following equation:

TAB = RE + PP + BEV

TAB: Market value of Total Assets of the Business (i.e., market value of the going concern);

RE: Real Estate assets to include land, buildings and other improvements;

PP: Personal Property to include furniture, fixtures and equipment;

BEV: Business Enterprise Value to include all intangible assets owned by the business.

Each of these methods, however, has flaws. The excess profits and management fee techniques focus on the business value, but fall short on equipment. The market rent method, which is required in New York State by case law, suggests that even private clubs be considered as daily fee courses, and rental estimates are often derived from revenues for items not directly related to real property. The best way to estimate market rent is from comps, and the author's extensive research of golf course rental comps over the years shows that they are not as common as one would like and that those that exist often lack tight enough trends to conclusively support the rental estimates. The method derived from the Appraisal Institute course using the equation (***TAB = RE + PP + BEV***), though logical, utilizes balance sheet values rather than real-world market values of the personal property assets.

ALTERNATIVE USE

Conventional thinking by laymen is that golf course properties are worth more if put to another use. Many times that is the case. However, alternative uses often are not available or feasible, creating a more complex issue. Recently, golf courses have closed at a more rapid rate than new ones have been developed and opened. During the past two years, approximately 300 golf courses have closed and between 30 and 35 have opened for play in the United States, according to the National Golf Foundation. Considering that most states require assessment valuations to be based on the highest and best use, it is critical to consider the potential alternative uses for golf courses and whether or not they represent a "higher and better" use.

In many instances, and especially those where golf courses are an amenity to a residential development, alternative uses are limited either by zoning or restrictive covenants. Most of these will result in the golf course being the highest and best use. Where the golf course is not economically feasible, the use is usually restricted to open space or recreation and the economic value is often limited. In some states, such as New York, case law [6] dictates that value must be developed based on the property's current use, which effectively eliminates the highest and best use question, even when the highest and best use is for alternative development.

Even in those (most) states where property is to be valued based on highest and best use, during recent years, development slowed because of market and economic factors. The result is that some golf course properties with development potential still have a highest and best use for golf, at least for a period of time. As real estate markets improve, this could change or could be anticipated to change, resulting in the possibility of golf representing an *interim*[7] use.

Not only do decisions vary from one jurisdiction to another but, in Ohio, for example, several cases were found that contradict each other. In one, all three approaches to value were rejected. Some states disallow the income or sales comparison approaches, or both. Some states require the property be valued based on continued present use, and others based on highest and best use. Still other states require certain, specific methodology be used in order to satisfy the apparent direction of recent decisions. In New Jersey, the recent decision in one case (Bear Brook[8]) rejects the income approach as follows:

> *The income approach is seldom appropriate in appraising a private nonprofit club or a municipal course* *Id. at 107;* *this court finds no distinction with semi-private courses such as Bear Brook.*

The Bear Brook Club was, in fact a *for-profit,* semi-private club, and yet the judge found no difference between it and either a private not-for-profit club or a municipal course. Further, the court stated:

> *While it is clear to the court that the Cost Approach is the most appropriate valuation method for Bear Brook, Fredon's Cost Approach must nevertheless be rejected for the deficiencies delineated hereinabove.*

The appraisal deficiencies noted by the court related to comparable land sales that were judged to be inadequate and post-dated the valuation date. Of particular interest is that several golf course owners recently were awaiting a pending decision in New Jersey Tax Court that might have answered the question of whether the cost approach is judged to be the only acceptable way to value golf courses for assessment in that state, or if appraisers are encouraged to employ more market-based methods within the income and sales comparison approaches. After two years of waiting for a decision, the sides settled, mainly because of the onerous financial burden of continuing to pay the (excessive) taxes on the property. So the question—at least in New Jersey—is still unsettled.

SOLUTION

It is difficult to imagine that every judge, lawyer and assessor would have ample time to educate themselves on the unique issues of golf property valuation. However, when in litigation, a solution is to focus on the applicable theory both in the appraisal report and in the oral arguments before the judge. It is incumbent on the appraiser to be able to explain and justify his/her valuation theory and for counsel to present a concise and understandable case for proper valuation theory. As a state's rights issue on taxation, judges in each state vary on their decisions in tax court, so consistency nationwide on methodology is unlikely. However, working toward stipulations on methodology from both sides, or seeking guidance from the judge after presenting these issues relative to the specific property, can help clarify and lead to improved and consistent methodology.

As part of the solution to this problem, it is advisable to consider the definition of market value. As offered by *The Online Dictionary of Real Estate Appraisal,* [9] the most widely used definition is: "The most probable price that the specified property interest should sell for in a competitive market after a reasonable exposure time, as of a specified date, in cash, or in terms equivalent to cash, under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, for self-interest, and assuming that neither is under duress." Inherent in this definition is that any appraisal assumes a sale. While many states have different variations on the definition of market value, most are similar and (at least) imply that same assumption. Few, if any sales are based on a cost approach analysis. As such, it is incumbent on appraisers, assessors, attorneys and jurists to also consider value as if a sale were going to occur and analyze the property as market principals would.

There is no one "right way" to appraise all golf course properties. As stated earlier, there are at least 11 or 12 different *types* of golf courses and each operates with different revenue and expense profiles and trades with different motivations and economics. We can conclude that in almost all cases, exclusive use of the cost approach is rarely consistent with market behavior and that most golf course properties trade based on either their operating history or operating potential to generate cash flow. It's the appraiser's job to know and understand not only the applicable valuation methodologies, but also the jurisdictional specifics that sometimes complicate the valuation exercise. ■

ENDNOTES

1. Fanning, Stephen F., "Segmentation of Golf Course Markets," *The Appraisal Journal,* January 2003, pp. 62–67.
2. Benson, M.E., "Challenges in Appraisal of Private Clubs," *The Appraisal Journal,* October 1, 1998.
3. Hirsh, Laurence A., "Private Golf Club Memberships – Real or Personal Property,*" Journal of Property Tax Assessment and Administration,* Vol. 4, Issue 3, 2009.
4. Income at that point in time when abnormalities in supply and demand or any additional transitory conditions cease to exist and the existing conditions are those expected to continue over the economic life of the property; projected income that is subject to change, but has been adjusted to reflect an equivalent, stable annual income.
5. Gimmy, Arthur and Buddie Johnson, *Analysis and Valuation of Golf Courses and Country Clubs,* The Appraisal Institute, 2003.
6. *New Country Club of Garden City v. Board of Assessors,* Supreme Court, Nassau County, Index No. 12696/88, June 4, 1991.
7. Interim use is the temporary use to which a site or improved property is put until it is ready to be put to its future highest and best use.
8. *Gale & Kitson Fredon Golf, LLC v. Township of Fredon,* 007359-2008; 004341, 2009, Tax Court of New Jersey, December 22, 2011.
9. *The Online Dictionary of Real Estate Appraisal,* 5th Edition, The Appraisal Institute, 2010.