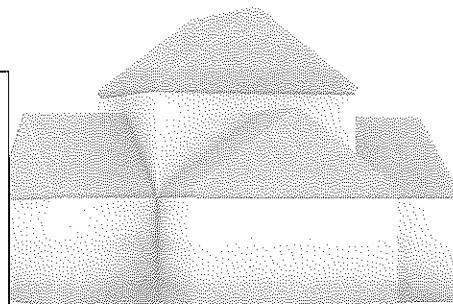


PROPERTY TAX ASSESSMENTS FOR PRIVATE CLUBS

Key Issues to Consider

BY LAURENCE A. HIRSH, CRE, MAI, SGA, FRICS



Let's establish a few facts about golf properties:

- Private clubs, though often nonprofit, are also 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 market value of golf course properties (including most private clubs) is almost exclusively driven by income-generating potential.

- Golf course properties are typically bought and sold as going concern businesses, and for ad-valorem tax purposes, an allocation between real and personal property is necessary to develop an accurate estimate of real property value.

It's often been said that you can't fight your taxes; you can only fight your assessment. Therefore, it takes an understanding of what goes into calculating real estate taxes in order to understand if your club's assessment is fair or should be contested.

What goes into Real Estate Taxes?

The fundamental elements are:

- Market Value of the Property
- Property Assessment
 - Assessment to Value Ratio
 - Common Level Ratio
- Millage Rate

The crux of ad-valorem (Latin for "as to the value") taxes is the property's market value. As most clubs combine real and personal property value, it is important to understand that in most states, it is real property (real estate) that is taxed and thus, what should be accurately valued and assessed.

There's no "one-size-fits-all" approach to appraising golf course properties for ad-valorem tax assessments. However, there are methodologies being employed

that simply do not reflect the actions of market participants. The real problem inherent in valuation of golf course and club properties for tax assessment cases is a lack of consistency between jurisdictions in golf property valuation methodology. The purpose of this article is to assist clubs in understanding what makes up their assessment and how (and whether or not) to contest it.

There are several distinct golf course properties: *private*, *public daily fee* and *resort*. Each requires consideration of different datasets to understand and place value accurately. In some states, courts have dictated that all courses be considered as *daily fee*, even though the property in question may be a private, membership club with entirely different economics and operations, and may even be part of a gated, private community that is prohibited by covenants or zoning from being open to the public. This approach not only distorts the actual property characteristics, but also further ignores that some private clubs are operated for profit. Thus, private clubs do have economic value, even if it might be limited. It is critical for clubs to understand these idiosyncrasies in order to effectively evaluate and, if appropriate, contest their assessment.

Market Value

This article focuses on private clubs, and like any other appraisal assignment, it is necessary to consider the three traditional approaches to value:

- Income approach
- Sales comparison approach
- Cost approach

INCOME APPROACH

The income approach is defined as "the present worth of future benefits." Without question, it is the method preferred by market participants. The income approach reflects the fact that clubs are going concern businesses and that they are sometimes purchased for income investment. However, in some jurisdictions private clubs are viewed as daily fee facilities, forcing the appraiser to "fit a square peg into a round hole." There are various types of golf courses and private clubs, each serving a different market segment and each targeting different clientele, often from different geographies.

For instance, many private clubs are

IS YOUR CLUB'S TAX ASSESSMENT FAIR?



member-owned and operated as non-profits. It is common to hear that a club "can't have much value because it doesn't make any money." On the other hand, taxing authorities claim that the only way to value such a "special purpose property" is by use of the cost approach. Neither is really accurate.

In the real world, there are also many private clubs that are operated for-profit, by companies and individuals in business specifically for the purpose of owning and managing private clubs for investment and income. In fact, many non-profit clubs have been sold to these operators in recent years, as member-owners have demonstrated limited ability to keep their clubs financially afloat. While some have become semi-private, or even daily-fee facilities, many have become for-profit, private clubs that have become, or are on the way to becoming, profitable. Since most member-owned private clubs would have economic value to a potential for-profit buyer, and there is clear evidence of a market for these properties, it is logical that valuing these clubs based on their potential for generating profit makes sense. This supports use of an income approach to value.

Depending on market dynamics, course characteristics and the size and quality of infrastructure and buildings, the property itself may be better suited to use as a private club, making use as a daily fee facility unlikely, or at the very least challenging and costly to adapt. Of course there are the potential issues of membership, the rights of members and refund obligations with private clubs that can result in a variety of legal issues that may affect the value of the real property, depending on the type of membership contract and other factors. Many clubs have membership deposits or initiation fee refunds as a liability that, in many cases, can be complex enough to discourage buyers altogether.

CONSIDERATIONS TO TAKE INTO ACCOUNT IF YOU ARE CONTEMPLATING AN APPEAL:

1. WHAT IS THE CURRENT ASSESSMENT?
2. WHAT IS THE OPERATING TREND OF THE CLUB FOR THE PAST THREE YEARS?
3. ARE THERE ANY ITEMS OF DEFERRED MAINTENANCE? ARE THERE BIDS TO ADDRESS THESE ITEMS?
4. HAS THE CLUB BEEN SOLD RECENTLY?
5. HAS THE PROPERTY BEEN MARKETED FOR SALE?
6. DOES THE CLUB HAVE INADEQUATE, ADEQUATE OR SUPER-ADEQUATE EQUIPMENT?
7. IS THE CLUB EFFICIENTLY MANAGED?
8. WHAT IS THE APPEAL DEADLINE AND HAS AN APPEAL BEEN FILED?
9. IF PRIVATE, DOES THE CLUB HAVE A FULL MEMBERSHIP? A WAITING LIST?
10. ARE THERE ANY EASEMENTS, COVENANTS OR RESTRICTIONS PRECLUDING ALTERNATIVE DEVELOPMENT OF THE PROPERTY?
11. IS YOUR STATE A "HIGHEST AND BEST USE" STATE OR ARE TAX ASSESSMENTS BASED ON THE PROPERTY'S CURRENT USE?
12. REMEMBER, TAXES CANNOT BE CONTESTED, BUT ASSESSMENTS CAN.

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.

SALES COMPARISON APPROACH

The sales comparison approach employs the principle of substitution whereby we compare sales of similar properties to develop an estimated value.

Several challenges exist in the sales comparison approach. In today's market, many such sales are distressed, or at the very least, not stabilized. This lack of stability makes comparison analysis difficult and sometimes limits the effectiveness of the sales comparison approach. If one has a sampling of stabilized sales considered

adequate, the sales comparison approach could be quite useful, and typically, it is the approach used to test the reasonableness of the income approach.

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

COST APPROACH

The cost approach is defined as a comparative approach to the value of property or, another asset that considers, as a substitute for the purchase of a given property, the possibility of constructing another property that is an equivalent to the original, or could furnish equal utility with no undue cost resulting from delay. >>>

RELEVANT ISSUES



Some of the more relevant issues to consider in a private club assessment evaluation include:

- **Jurisdictional Issues.** How does the local law require properties to be appraised? Highest and best use or present use? Which approaches are required to be used and which are either frowned upon or prohibited? Are there unique valuation methodologies resulting from case law? Can someone other than legal counsel represent a taxpayer?
- **Highest and Best Use.** In those states requiring values based on highest and best use, has a proper analysis been done to determine what the property's highest and best use may be?
- **Property Characteristics.** Does the club have characteristics that either enhance or detract from its market value?
- **Membership Structure.** Should the value of equity memberships, if applicable, be considered? What is the (impact on) value of the membership refund liability?
- **Recent Performance.** How has the club performed recently? Is it trending up or down?
- **Property Condition.** Are there maintenance items presently in need of attention that can be quantified?
- **Sales of Other Clubs.** At what price have other clubs been sold and what prompted the sales?
- **Assessments of Other Clubs.** Most states require uniformity in how assessments are developed. In some cases, using the assessments of comparable properties can be helpful in developing a contested assessment.
- **Financial Status of Community and School District.** This is important because it can often determine how aggressive or cooperative the taxing authorities may be in negotiating a revision to the tax assessment. In today's fiscally challenging times, many jurisdictions fight assessment appeals vigorously, while others, not having the funds to pursue legal recourse may be more willing to negotiate.
- **Allocation of Real & Personal Property.** Private clubs are operating businesses that are bought and sold as such. Accordingly, extracting the real estate value for an appropriate real estate tax assessment is critical. The methods that exist aren't fool-proof, but address this often-significant issue. Since only real estate is taxable in most states, a value of the real property only is critical. Simply valuing the going concern (business and real estate) is likely to result in an over-valuation for tax assessment purposes; thus allocation is often an issue that can determine whether or not an assessment is fair.

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 like golf courses and clubs.

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. However, the land

value is not a significant factor if the golf course or club is the "highest and best use," which is defined as the most probable use of a property, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued. Feasibility of alternative development is not normally an issue once the property is already developed, and golf courses are not so "special purpose" that the other approaches can't be considered. Most buyers and sellers

completely disregard the cost approach. Depreciation is very difficult to measure accurately and the costs are both difficult to estimate and as relevant for valuing an existing course as the original new purchase price is for valuing a used car.

In assessment cases, the cost approach is often used by taxing authorities because it can be done with limited market data, because assessors have useful software and because it often yields the highest value estimate.

Assessment

A property's assessment is the amount on which that property's taxes are based. It may be consistent with market value, but subject to a ratio as described below:

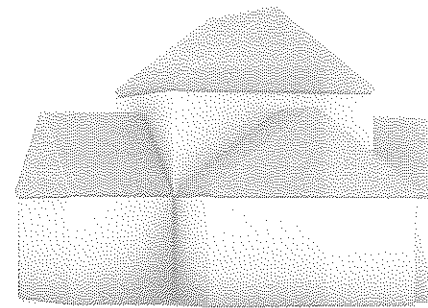
ASSESSMENT TO VALUE RATIO

Often, the taxing jurisdiction will establish an assessment to value ratio. This is the percentage of market value at which all properties are assessed. It can be 100 percent or less, as determined by local governance. If the ratio is 100 percent, then all properties are theoretically assessed at market value. If less, assessments are based on the designated percentage of market value.

COMMON LEVEL OR EQUALIZED RATIO

In many jurisdictions, an analysis is performed annually to calculate the equalized ratio of actual assessments to sale prices of properties for that year. If such a system is in effect, the implied market value from the assessment might be considerably different than what the market would otherwise indicate. For example, if a property's assessment was \$1 million and the equalized ratio was 50 percent, it would indicate an implied value of \$2 million. However, if the actual market value of the property was less than \$2 million, an assessment of \$1 million could be excessive.

THE FUNDAMENTAL ELEMENT OF AD-VALOREM (LATIN FOR "AS TO THE VALUE") TAXES IS THE PROPERTY'S MARKET VALUE.



These ratios can range anywhere from just under 100 percent to 5 percent or less, especially when reassessment hasn't occurred for many years.

Millage Rate

The millage rate is what actual tax bills are based on. It usually has at least three components: county, municipality and school district. Each of these taxing bodies sets their millage rate each year and this rate is then applied to the assessment to calculate annual tax liability for each property in that jurisdiction. Sometimes, there are also taxes for fire protection, library or other public services added to this rate. Millage rates cannot typically be contested.

HOW CAN A CLUB DETERMINE IF ITS ASSESSMENT IS FAIR?

Having a basic understanding of the assessment process and applicable laws is the first step. Knowing the realistic value of the club and more importantly, the real property (real estate) and applying the appropriate ratio determines the basis for assessment. Understanding issues in your jurisdiction, like whether the club needs to be considered as a club or for another (potentially more valuable) use and what valuation methodologies are likely to be relevant, will go a long way in determining if it is wise to contest their assessment.

Different Approaches to Assessment Appeals

There are four basic methods to contest an assessment:

■ **"Do it yourself."** While this method is the cheapest, it is often the least effective, given the complexities that may arise. This method often works well with residential homeowners but not always with complex properties like clubs.

■ **Engage a contingent fee tax rep.** This is often the most expensive method, but offers the least amount of risk to the taxpayer. Tax rep firms typically pursue the best cases and then require a significant percentage of the tax savings achieved. There is no up-front cost to the taxpayer, but many jurisdictions either don't allow tax reps without legal counsel or frown upon working with them. They work on contingent fees, by nature seeking the lowest assessment and not necessarily seeking an accurate valuation. There are some quality tax rep firms and it really comes down to a choice between risk and reward. Is a club willing to invest upfront to keep most of the savings and potentially receive more favorable treatment from the authorities, or does it prefer a more risk-free approach? It may depend on the strength of the case for appeal.

■ **Hire legal counsel.** Lawyers work both on contingent fee and an hourly-rate basis and are likely to request that the taxpayer retain an appraiser. Some taxpayers try to avoid retaining legal counsel, at least until the case gets to a point of litigation.

■ **Hire an appraiser.** The appraiser evaluates the strength of the case and manages the upfront costs. It is imperative that the appraiser work on a pre-agreed, flat fee to ensure credibility as an expert witness. Beginning in 2014, appraisers will be permitted to work on contingent fee with full disclosure and time will tell how effective that change to appraisal industry standards will work.

These methods are not mutually exclusive. It is common for an appeal to involve one or more of these options and the choice hinges on the risk preference of the taxpayer (club) and the potential size of the case. In most cases, especially those that go to court, a lawyer and an appraiser will be necessary, even if the taxpayer retains a tax rep firm.

Alternative Use

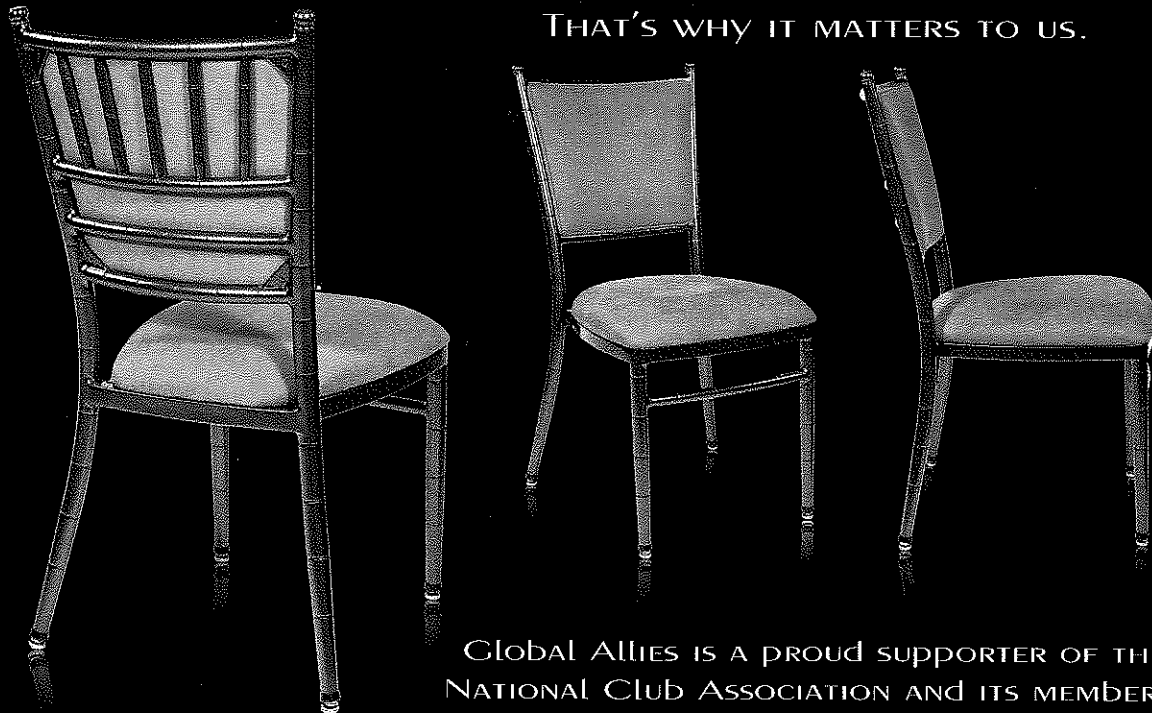
Conventional thinking holds that golf course properties are worth more if put to another use. Sometimes that is the case; however, an alternative use is often not permissible or feasible, making this a more complex issue.

In recent years, golf courses have closed at a much more rapid rate than new ones have been developed. During the past two years, approximately 300 golf courses have closed and between 30 and 35 have opened for play, according to data compiled by the National Golf Foundation. Furthermore, in 2008 NGF estimated that as many as 15 to 20 percent of private clubs were considered to be in distress and had begun allowing public/ daily fee play, altering their status as private clubs. Considering that many states require assessment valuations to be based on highest and best use, it is critical to consider the potential alternative uses for private clubs and whether or not they represent a "higher and better use."

In many instances, especially where clubs are an amenity to a residential development, alternative uses are limited either by zoning or restrictive covenants. Most will result in the club being the highest and best use, sometimes for no other reason than the fact that it is required to remain private. Where the club is not economically feasible, the use is usually restricted to open space or recreation and the economic value is often limited. In some states, like New York, even when the highest and best use is for alternative development, case law dictates that value must be developed based on the property's current use. This, in effect, eliminates the highest and best use question, even though some interpret valuation procedures as requiring consideration as a daily fee golf course.

Not only do decisions vary from one jurisdiction to another, but in some >>>

QUALITY MATTERS TO YOUR MEMBERS AND GUESTS.
THAT'S WHY IT MATTERS TO US.



Global Allies is a proud supporter of the
NATIONAL CLUB ASSOCIATION AND ITS MEMBERS.

GLOBAL
ALLIES

The Positano Banquet Chair • Stacks 8 High
Patented & Available Exclusively from Global Allies
www.globalallies.com • clubs@globalallies.com • (415) 453-6041

© 2012 Global Allies, LLC • All Rights Reserved

areas, cases contradict each other. For example, in one Ohio case, all three approaches to value were rejected. Some states disallow the income or sales comparison approaches, or both. A few states require that the property be valued based on continued present use, which normally benefits the club. In most states however, values must be based on highest and best use, which can result in a dispute between the taxpayer and taxing bodies. Still other states require specific methodology, be used to satisfy the direction of recent decisions.

Examples from the Courts

A recent decision in one New Jersey case, *Gale & Kitson Fredon Golf, LLC v. Township of Fredon* (Bear Brook), rejected the income approach.

The Bear Brook Club was a for-profit, semi-private club and yet the judge found no difference between that club and either a private nonprofit club or a municipal

course. Further, the court rejected the cost approach for deficiencies.

The deficiencies were related to comparable land sales that were judged to be inadequate and that post-dated the valuation date. The judge's decision was clearly inconsistent with the market, but must be considered in strategy planning for assessment cases in New Jersey.

As part of the solution to this problem, it is advisable to consider the definition of market value. As offered by *The Appraisal Dictionary*, 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 def-

inition, most 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.

Private clubs present a difficult challenge to tax assessors and courts. They are unique properties with unusual and sometimes limiting characteristics that few appraisers comprehend. Achieving a fair assessment requires a comprehensive approach, with experts in local tax assessment law and procedure, a qualified and experienced appraiser with an understanding of private clubs, and the ability to explain the valuation as an expert witness. ■

Laurence A. Hirsh, CRE, MAI, SGA, FRICS is the president of Golf Property Analysts, a leading golf and club property consulting, appraisal and brokerage firm based in Philadelphia. He can be reached at larry@golfprop.com.