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Valuation of Golf Course in a Tax Assessment Challenge

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It is rare to have an opportunity to write about a decision involving a tax certiorari proceeding. The decision, *Matter of Hempstead Country Club v. Board of Assessors*, 2013 N.Y. App. Div. LEXIS 7156, a 19-page decision decided Nov. 6, 2013, was authored by Justice Thomas A. Dickerson. I had the benefit of actually being in the Appellate Division, Second Department, to argue another matter and enjoyed listening to oral argument of this appeal. What was involved was a challenge to tax assessments made on 123 acres of property in Nassau County used as a private, not-for-profit golf course.

The consolidated proceedings were tried in Nassau County Supreme Court before Justice Stephen A. Bucaria who granted the petitions awarding reductions in the assessments, 2010 N.Y. Misc. LEXIS 3281 (2010). Bucaria's erudite decision contained a complete discussion of the leading cases in each department which accepted the "assessor's formula" as well as a review of all prior decisions on the valuation of private golf courses.

The parties agreed that the property should be assessed as if it were a for-profit golf course. They also agreed that the income capitalization method of valuation was the proper approach for the purposes of the assessments. Simply put, this approach finds the present value of real property based on its future income by dividing a capitalization rate into the estimated net income.

Although the parties' respective appraisers agreed that the amount of real estate taxes imposed on the property should be taken into account when computing the property's fair market value, they differed on how to do so. The country club's appraiser converted the leases for his comparable properties into gross leases under which the owner, rather than the lessee, is obligated to pay the real estate taxes, and utilized the "assessor's formula" pursuant to which a factor is added to the capitalization rate to account for real estate taxes.

The appellant assessor's appraiser adopted an approach assuming a triple net lease, under which the lessee, not the owner, is obligated to pay real estate taxes. Therefore, the expense of real estate taxes is accounted for in the fair market rent for the property and need not be accounted for in the capitalization rate. Additionally, the assessor's appraiser downwardly adjusted his rent-to-revenue ratio, used in determining the fair market rent for the property, to account for high real estate taxes in the subject location.

The lower court adopted the approach proposed by the country club.

Appeal

As Dickerson framed the issue on appeal, he noted that the court must decide on the appeal whether the approach advocated by the country club was "fair and non-discriminating," was "acceptable," and resulted in a fair market value assessment of the subject property, or, as argued by appellant, it resulted in improper "double counting." Interestingly, the court noted, "we must make this determination against a background which includes the fact that, in a case decided in 2007, *Matter of Mill Riv. Club v. Board of Assessors*, 48 AD3d 169 (2d Dept. 2007), a tax certiorari proceeding challenging the assessment of parcels on which a private, not-for-profit golf course was operated, this court approved

of the triple net lease approach advocated by the taxing authority in that case and by appellant here." Obviously, the appellant thought that with this precedent it had a reasonable chance of reversal. But precedent does not always predict a judicial result.

Fortunately, some clue to the outcome was present in the excellent brief written by Jon N. Santemma¹ who argued the appeal.

Although the decision under review adopted the "assessor's formula," it did not easily define what it was. The definition is found in *Senpikie Mall v. Assessor of New Hartford*, 136 AD2d 19, 22-23 (4th Dept. 1988). In *Senpikie Mall*, the court stated:

[I]n using the income approach for tax certiorari purposes, the proper method is not to deduct the existing real estate taxes as an expense, but instead to use what is called the "assessor's formula" by adding to the capitalization rate a factor which will mathematically account for the proper amount of taxes based upon the income value as computed [citing *Master of Commercial Structures v. City of Syracuse*, 91 AD2d 1197, lv denied 59 NY2d 606].

The Fourth Department further noted that the "assessor's formula" is appropriate regardless of who pays the tax, and wrote:

[T]he value of real estate for assessment purposes is not affected by any agreement between the owner and the tenant. The income approach to valuation is based upon an estimate of the economic or market rent for the leased premises. The economic or market rent takes into account all of the fair and reasonable payments, judged by rents in the marketplace, that a tenant makes for the use of the premises. If the tenant pays all or a part of the taxes, that additional payment may be considered as part of the economic rent. (*Senpikie Mall* at 22-23).

The Board of Assessors argued in its brief that reliance on *Senpikie Mall* was misplaced because valuation of actual income producing property should be done differently from valuation of hypothetical income-producing property such as golf courses.

The appellant argued that a tax load factor should not be used in the capitalization rate. Rather, taxes were to be taken into account in the process of settling on a rent-to-revenue ratio. Essentially, as Dickerson noted, the appellant's appraiser accounted for the cost of real estate taxes by using the triple net lease approach, where income incorporates the expense of taxes, thereby eliminating the need to adjust the capitalization rate.

Several Important Aspects

What makes this decision interesting is that the board of assessors certainly had a basis to appeal. The Second Department had previously approved the same triple net lease approach used by appellant in *Mill Riv. Club* but, nevertheless, found it was not bound to use that approach.

There are several important aspects of the decision. The first is that only the subject real property was being valued, independent of the business conducted on the property. "In a tax certiorari valuation, the income stream subject to capitalization measures the rental value of the property, exclusive of the business conducted on the property." *Matter of Miriam Osborn Mem. Home v. Assessor of City of Rye*, 80 AD3d 118, 142 (2d Dept. 2010).

Hempstead Country Club also confirms that under the well-established law, in assessment proceedings, the value at which real property may be taxed has been equated with market value. "[A]ny fair and nondiscriminating method that will achieve [the tax assessment goal of arriving at a fair market value] is acceptable." *Matter of Gordon v. Town of Esopus*, 31 AD3d 981, 982 (3d Dept. 2006).

Here, both parties agreed that the income capitalization approach was the proper method for valuing the subject real property. Under this approach, value is calculated by dividing the expected income that a property can produce by a capitalization rate. So how does one consider real estate taxes?

If the "assessor's formula" is to be used, a tax load factor should be applied to the capitalization rate. The appellants argued that the "assessor's formula" was not appropriate for valuing a golf course because it "double counts" real estate taxes as an expense.

Interestingly, the comparables used by the appraisers included tax-exempt municipal or state properties. The rentals paid by these entities were then gross rentals. The petitioner's expert proposed that the market rent for the subject should be calculated as if the hypothetical tenant operated the property under a gross lease. Dickerson noted that, under this methodology, the petitioner's expert added a tax load factor to the proposed capitalization rate, which had the effect of further reducing the estimated value of the property.

Reading the Hempstead Country Club's appellant brief provides some interesting insight to the problem of non-taxed golf courses, and low or high tax rate golf courses. Apparently, Nassau County has 1,600 or more different tax rates. The golf course argued that the "assessor's formula" takes the gamesmanship out of the selection of comparables. Adding a tax factor creates a level playing field of comparability among the comparables for comparison of the comparables to the subject. It was argued that different tax burdens in the comparables affect the amount a tenant will pay in rent whether the rent is fixed or based on a percentage of gross business revenue. A comparable net percentage rent must be adjusted to the subject to account for the difference in taxes paid.

It bears repeating that if any fair and non-discriminating method that will achieve the tax assessment goal of arriving at a fair market value is acceptable, and if valuation is largely a question of fact where the courts have considerable discretion in reviewing the evidence, it was not that surprising that the Appellate Division affirmed the judgments, holding it was proper to add a tax load factor to capitalization rate in order to account for the cost of real estate taxes.

Another well-known tax certiorari attorney, David C. Wilkes, when asked for his view on the case, commented that it was a well-reasoned decision that recognizes there is not a cookie-cutter approach to valuation, particularly for complex valuations like golf courses in which market evidence is inconsistent for various factors. This provides appropriate deference to the trier-of-fact to interpret and apply the testimony and credibility of the experts before them.

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Endnotes:

1. Michael R. Martone and Michael P. Guerriero were with him on the brief.

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