

**Matter of Hempstead Country Club v Board of
Assessors of the County of Nassau**

2010 NY Slip Op 31831(U)

July 15, 2010

Supreme Court, Nassau County

Docket Number: 412484/07

Judge: Stephen A. Bucaria

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MEMORANDUM DECISION

Supreme Court, Nassau County, IAS Part 2

In the Matter of the Application of
HEMPSTEAD COUNTRY CLUB,

HON. STEPHEN A. BUCARIA, J.S.C.

INDEX NO. 412484/07 and 401842/07

Petitioner,

-against-

THE BOARD OF ASSESSORS, THE BOARD OF
ASSESSMENT REVIEW and THE ASSESSMENT
REVIEW COMMISSION OF THE COUNTY OF
NASSAU,

Respondents.

DECISION AFTER TRIAL

In this Real Estate Tax Review proceeding instituted pursuant to Article 7 of the Real Property Tax Law, the Petitioner, Hempstead Golf and Country Club, seeks a review of the assessed valuations placed upon its facilities for the following taxable status dates and the respective tax years – starting date January 2, 2005 for tax year 2006/07; status date January 2, 2006 for tax year 2007/08 and status date January 2, 2007 for tax year 2008/09.

By prior order of this Court, made and entered the 6th day of July 2009, the tax years were consolidated into a single proceeding against the County under Index no. 401842/07 while a separate series of cases were consolidated under Index no. 412484/07 for proceedings against the Incorporated Village of Hempstead, and a joint trial was scheduled. The parties have resolved the issues between the Petitioner and the Village of Hempstead and hence those matters are no longer before the court and were severed from the joint trial pursuant to stipulation of counsel for the Petitioner and Respondent Village was made in open Court at the commencement of trial.

The trial on the County matters commenced on Tuesday, December 2 and

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continued through December 8, 2009.

The property in question is a country club complex on 125 acres with approximately 123 acres in the hamlet of West Hempstead improved with an 18-hole golf course which was constructed around 1920 and some two acres of property located within the Village of Hempstead which essentially constitutes the clubhouse portion of the subject property.

The course plays to a length of 6,611 yards, is a par 72, slope 134, course rating 71.8 which the Respondent's appraiser has characterized as "challenging".

The clubhouse was originally constructed around 1900 as a farmhouse and through the years has been expanded, modernized and reconstructed. The improvements over the years at issue include a large 42,000 square foot clubhouse with detached pool, cabana, maintenance complex and four tennis courts.

The facility is operated as a not-for-profit private club.

The parties each called one witness. Petitioner's witness was Jeffrey Dugas, of Cheshire, Connecticut while the Respondents called Stephen R. Hughes of Leawood, Kansas. Both have extensive background in real estate appraisal, particularly in the area of golf course valuation, and both are members of the American Institute of Appraisers of the Society of Golf Appraisers among other qualifications.

Each appraiser applied a valuation analysis under which the club is valued as a privately operated for-profit daily fee operation. That approach is consistent with the decisions of former Justice De Maro of this Court in the Creek Inc. Index no. 406016/03, Rockville Country Club Index no. 22488/08, Mill River Club Index no. 3306/97 and North Shore Country Club Index no. 400961/03. The Mill River decision was upheld by the Appellate Division at (48 AD3d 169, 2nd Dept., 2007).

Golf course valuation for tax purposes was the subject of a lengthy and learned decision by Justice Frank S. Rosetti, late of this Court, in New Country Club at Garden City, Supreme Ct. Nassau Co., Index no. 12696/08 (1991), which established that country clubs were to be valued on the basis of a value in use as a golf course rather than on the basis of the value of the underlying land if it achieved some redevelopment or alternative use. The approach then evolved, through the series of four cases in 2005 to the concept expressed in both of the within appraisals for valuation as for-profit daily fee public courses. Daily fee public golf course analysis was the model adopted by the court in each

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of former Judge DeMaro's decision.

The factual issues presented to the Court in this case are essentially the same as in commercial certiorari proceeding, namely the capitalization of real estate income, here the income is ascribed for rent paid by the operator of a privately owned public daily fee golf course operation.

Both appraisers have estimated revenue from a daily fee operation for the subject property based on the number of rounds that could reasonably be generated at the site and the amount of required greens fees per round. Mr. Dugas, for the Petitioner, also made a study as to what revenues would be generated from the operation of the clubhouse were it to be available as a public adjunct to the daily fee course. Mr. Hughes made no such study. Mr. Hughes estimated what he believed would be the revenue, based upon his experience in the industry. Both experts made estimates as to the value of merchandise that could be generated at the site in terms of sales and other income for such usage as golf driving range, tennis, swimming, etc.

It was essential for the Court to recognize, at the beginning, that the numbers that are suggested by the experts for revenue in connection with greens fees, restaurant, merchandise and "other" are in fact revenues generated by the operation of businesses on the subject property. The within matter must relate only to the real estate. No real estate tax may be placed upon the value of the restaurant business, the golf business, the personal property generating income to the business or the furniture, fixtures and equipment generating income. In fact, in New York State no property tax may be placed upon any personal property (RPTL §300).

It is therefore essential to take the business component out of the valuation process and to determine the proper amount of rent that would be paid to the landlord as if the owners of the facilities decide to lease the property for use as a golf course facility.

Both experts estimated percentage rents from examination of percentage leases in the Northeast that are attributed to each class of income for golf use, restaurant use, and merchandise use. In that way they calculated a percentage rental from gross revenues that could be derived at the site.

The final step is to translate the rental income into a value based on capitalization of the income stream. Mr. Dugas, for Petitioners, utilized a "gross" analysis in which he viewed the rental obligation of the tenant as including the actual taxes paid as part of economic rental. He added the actual taxes paid on each comparable rental to determine

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the "grossed-up" percentage rent paid and then capitalized the resulting income figure by a rate sufficient to reflect an appropriate equity investment, reasonable mortgage and the proper amount of taxes. Thus, his capitalization rate included three components, the last being "tax load factor", or the actual tax rate multiplied by the stipulated class 4 ratio. This approach is referred to as "the assessor's method".

Mr. Hughes assumed that the rental amounts would be "triple net" under which the tenant pays the real estate taxes. Mr. Hughes argued that his rent should be adjusted so as to reflect the burden of real estate taxes, particularly where the property has a "relatively higher subject tax burden" (Respondents Exhibit A page 69).

In his appraisal, Mr. Dugas converted his gross approach to net figures so that the Court would have available to it a comparison between the two appraisals. Mr. Hughes did not make a corollary analysis as to the value where the tenant of the comparable paid taxes that were different in amount than were paid on subject. In fact, Mr. Hughes did not report the actual taxes on the subject, or on any comparable except for municipal leases in which there were no taxes.

At the beginning, the Court's analysis will be directed at the proofs as they relate to rounds, greens, fees and other business income. The Court will then address the percentage leases and the issue of the capitalization.

It should be pointed out that Mr. Hughes was supplied certain data from the County of Nassau in connection with his preparation of his analysis. That included the appraisal reports previously prepared by Mr. Dugas for the 2005 trials, and the appraisal prepared by Price Waterhouse Cooper, (Douglas Main) for the County, also for the series of 2005 trials. Mr. Hughes testified candidly as to his use of material from the other appraisals, and testified that he used that material in this appraisal when he felt that it was in accordance with his own experience, and with other materials that he had received and reviewed through the years, including additional information from Mr. Main.

With respect to greens fees, Mr. Hughes found rounds of 37,500 for each of the three years under review while Mr. Dugas found 35,000.

Mr. Hughes observed that the subject property, a "challenging golf course", could produce annual rounds in the range of 55,000 to 60,000 or more, similar to the courses at Eisenhower Park, Dyker and Clearview, which courses, designed as high volume public golf courses, generate play of that magnitude. Mr. Hughes then disregarded the possibility of generating 60,000 rounds and fixed his rounds at 37,500, but did not supply

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any adjustment of his comparables to justify that conclusion.

Mr. Hughes acknowledged, on cross examination, that there was an inverse relationship between the number of rounds that a golf course generated and the amount of greens fees that would be paid. In other words, one would expect a public course such as Nassau County public courses Eisenhower Park, which is generating substantial rounds, would have a corresponding low greens fee. Five of Petitioner's comparable courses are simultaneously analyzed for both number of rounds and greens fees. Both appraisers refer to the Hamlet Windwatch course as comparable to the subject property in terms of the number of rounds. That facility hosted 34,000 rounds annually and the Court finds that the Hamlet Windwatch is the most comparable to the subject property in terms of both an annual round count and a daily fee basis. Mr. Hughes based his comparable greens fees on municipal courses with the exception of the Hamlet Windwatch and Long Island National but in each instance of municipal courses he used a non-resident weekend rate, including non-resident weekend rates for the Black course at Bethpage. Mr. Hughes acknowledges that the facilities at Bethpage may be used by any resident in the State at fees approximately half of the fees charged to non-residents. The same approximate percentage reduction is available to residents of Nassau County or of the Nassau towns, for the courses of those municipalities and Mr. Hughes' report lacked data as to the greens fees charged to residents on those municipal courses. In using the Hamlet and Long Island National, Mr. Hughes also based his conclusion only on the weekend greens fees with carts.

The Court adopts Mr. Dugas' greens fees which are essentially based on free market privately owned public daily fee golf courses on Long Island and not on peaktime non-resident public fees paid by non-residents on municipal and state facilities.

The Court also accepts Mr. Dugas' figures for food and beverage primarily because Mr. Hughes made no study whatsoever in connection with food and beverage and accordingly has no factual material to support his conclusion. The Court accepts Mr. Dugas' conclusion at the \$7,000 per seat or \$80 per round which the Court notes is \$13 per round higher than Mr. Hughes' estimate.

The Court also accepts Mr. Dugas' merchandise figure of \$9.00 a square foot as compared to Mr. Hughes \$9.50 and "other" at the \$5.00 instead of \$5.30.

Accordingly, the Court finds the following income revenue for each year for the operation of the business and the real estate at the subject location as per Petitioner's proof as: for January 2, 2007 golf \$2,756,250; food and beverage \$2,800,000;

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merchandise \$315,000; other \$175,000; Total \$6,046,250; for January 2, 2006 golf \$2,715,650; food and beverage \$2,758,621; merchandise \$310,450; other \$169,903, Total \$5,954,624; for January 2, 2005 golf \$2,675,400, food and beverage \$2,717,853, merchandise \$305,900 and other \$164,954, Total \$5,864,107.

The issue of finding proper percentage rentals requires an analysis of the proper approach to use in the capitalization of real estate income.

In Mill River v Nassau, supra, the Appellate Division held that it was “not error” to utilize the “triple net” approach to value each golf facility as the trial court had done in that matter. In that approach, adjustment is made to the percentage rent in order to produce values consistent with the different tax rates affecting the various comparable facilities.

It is undisputed that Nassau County has, within its geographic boundaries over 400 different taxing districts, ranging from Towns and school districts, to special districts which provide services varying from water supply to solid waste removal and disposal, to parks, library, lighting, police, fire and other districts. The result is over 1,600 different tax rates in Nassau County. Tax rates vary substantially throughout the County. For example, the tax factor in the same year for the subject property is 7.08%; while at Rockaway Hunting Club it is 4.73% and on Glen Head 4.38%. Rockville Country Club is 7.650% (Exhibit 5A). Moreover, the taxes and tax rates on the comparable golf courses outside of Nassau County are, without exception, substantially lower than the subject and many of the comparables are tax exempt so the tenant pays no real estate taxes.

The issue before the Court is whether to adjust for the differences by applying a tax factor to the capitalization rate as is done generally in commercial tax certiorari cases (the assessor’s formula), or whether to adjust the percentage of gross receipts allocable to the rent to reflect greater or lesser percentages as was accepted in Mill River, supra.

The use of a tax factor is probable best laid out in Senpik Mall v Assessor, 136 AD2d 19 (4th Dept., 1988). The Court stated:

In 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 Matter of Commercial Structures v City of Syracuse, 91 AD2d 1197, lv denied 59 NY2d 605]. . .

The use of the "Assessors Formula" to account for the tax expense is understandable, where the owner pays the taxes. . . The use of the formula is also proper where, as here the tenant and not the owner is responsible for the taxes. The 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 responsible payments, judged by rents in the marketplace, that a tenant makes for the use of the premises. If the tenant pays all or part of the taxes, that additional payment may be considered as part of the economic rent. For equivalent space, one tenant may pay the landlord \$800 per month in rent and \$200 for taxes and another may pay \$1,000 for rent with the landlord paying the taxes. In both cases, the lease is indicating market rent of \$1,000 per month regardless of how portions of the total rent may be determined. Thus, in computing an economic or market rent, the appraiser may properly consider as rent and include in the estimated gross income, not only those amounts denominated in the lease as rent, but also any additional amounts paid by the tenants, such as those denominated as payments for taxes. And, if the appraiser

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does include in his estimate of gross income the amounts designated as payments for taxes, as he did here, he must then account for them as an expense to the owner. In order to avoid distortion, however, he should not deduct the taxes actually paid from the gross income, but he should use the "Assessor's Formula". (id. at 22-23)

Following his decision in New Country Club, Judge Rosetti issued a decision in Merge Company v Nassau County (Index no. 770/89), decided October 7, 1992 (copy annexed) which decision accepted the "assessor's formula" theory advanced by Nassau County and which was consistent with Senpike. The Court held that in determining the rent to be capitalized, net income from comparable properties should be adjusted by adding the amount of taxes the comparable pays to determine a rent corresponding to net rent plus tax expense on the comparable. Dividing that figure by adding a tax factor to the capitalization rate produces a value for the subject and, at the same time, the appropriate tax burden found for the value of the subject.

The County successfully argued in Merge that the 1,600 differing rates in Nassau must be considered as different occupancy costs that directly and inversely relate to rent. Essentially, even though the tenant paid taxes as a "net" rent (or "triple net") as to taxes, the Court held in Merge that the Court could not ignore the total occupancy cost of the comparable in fixing economic rent for the subject property. Justice Rossetti rejected the petitioner's approach, which failed to use tax factors event though, as the petitioner argued, industrial leases are customarily net leases. Justice Rossetti noted that the argument had only "superficial appeal" because inevitably lease rents are always "at least partially influenced by the differences in the taxes on the properties".

In Merge Company, Judge Rossetti noted that most of the petitioner's comparable leases were outside the subject's location (Plainview) and almost half were in a different county (Suffolk County). Thus, these comparable rentals:

were subject to different equalization and tax rates and, absent a showing their rates approximated subject's, adjustments were called for. Given the significant amounts of these taxes, both absolutely and relative to rentals (especially in such a highly taxed

area as Long Island), we do not believe it proper to simply disregard differences in taxes between the comparables and subject (citations omitted).

Justice Rossetti went on to state that:

“Since it is conceded that taxes are a significant factor in the market’s determination of rental value (even petitioner’s expert makes such an admission), differences in this regard between subject and the comparables on which income values are based should be accounted for. The inclusion of appropriate adjustments to comparable rentals and the application of appropriate capitalization tax rates adequately does so. . .(citations omitted). . .Totally disregarding taxes does not”. (Merge, supra)

Subsequent to its 2007 decision in Mill River the Second Department followed Senpike in its May 2008 case of VGR Associates LLC v Assessor, 51 AD3d 678 (2nd Dept., 2008). In VGR, the Appellate Division noted that the “court properly followed the petitioner’s analysis for the treatment of real estate. . .taxes using the assessor’s formula”. (*Id.* at 679). The Appellate Division stated that “[e]conomic or market rent takes into consideration all the fair and reasonable payments, judged by rents in the market place, that a tenant makes for use of the premises”. (*Id.*) Reading Mill River and VGR together, the issue of whether to use a tax factor or a subjective net approach is in the court’s discretion.

Broad support for the use of the objective tax factor in the assessor’s formula has been applied throughout the state in the following recent decisions. The Third Department, in Ames #82 v Board of Review, 173 AD2d 943 (3d Dept., 1991), also cited Senpike with approval for the principle that tax factors are appropriate in the capitalization of income approach. There, the court said that when utilizing the income approach to determine value for a tax certiorari proceeding, “real estate taxes are not deducted as an expense, but instead the ‘assessor’s formula’ is used by adding a factor to

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the capitalization rate”. (*Id* at 944, n. 2). The court noted that under the assessor’s formula - the “real estate taxes are added back to obtain net operating income before taxes, and then considered the tax factor”. (*Id.*) Other recent decisions from the Third Department, such as PCK Dev. Co., LLC v Assessor of Ulster, 20 AD3d 660 (3d Dept., 2005) and Myron Hunt/Shaker Loudon Assocs. v Bd. Of Assessment Review, 6 AD3d 953, 956 (3d Dept., 2004), approvingly cite Senpike in support of the assessor’s formula and the use of tax factors as “a proper part of an income capitalization approach”. Myron Hunt/Shaker Loudon Assocs., 6 AD3d 953, 956.

In In re Tipp Hill Assocs., The United States Bankruptcy Court for The Northern District has also cited Senpike for support for the use of the assessor’s formula’s tax rate factor.¹ In re Tipp Hill Assocs., 1996 Bankr. LEXIS 1741 at *10.

In Warren’s Weed New York Real Property treatise in the section on Income Capitalization for the chapter on Tax Certiorari Valuation, the treatise states that “[u]nder income capitalization in tax certiorari valuation, it is appropriate to add a tax factor to the capitalization rate rather than to deduct from income the real estate taxes as an operating expense”. (§132.21) (citing Senpike Mall Co., *supra*).

Senpike also notes that use of the tax factors under the assessor’s formula is acceptable where the tenant pays the real estate taxes under a net lease or when the landlord bears the tax burden. (135 AD2d 22-24). As the court in Senpike notes, “The value of real estate for assessment purposes is not affected by any agreement between the owner and the tenant”. (*Id.*) As previously observed, (Senpike, *supra*), the court provided the following example:

¹ The court noted: “In using the income approach for tax certiorari purposes, both appraisers properly deducted the existing real estate taxes as an expense and applied the “assessor’s formula”. Using this formula, a tax rate factor is derived by multiplying the tax rate per thousand by the tax equalization rate and dividing the result by 1,000. The factor is then added to the capitalization rate and the combined percentage divided into net income. This approach is intended to correct any distortion of value that would otherwise occur if real property taxes were included as an expense”. *In re Tripp Hill Assocs.*, 1996 Bankr. LEXIS 1741 at *10, n.5.

“The economic or market rent takes into account all of the fair and reasonable payments, judged by rents in the market-place, 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. For equivalent space, one tenant may pay the landlord \$800 per month in rent and \$200 for taxes, and another may pay \$1,000 for rent with the landlord paying the taxes. In both cases, the leases indicate a market rent of \$1,000 per month regardless of how portions of the total rent may be determined”. (*Id.* at 23).

It is noteworthy that the Respondent’s expert, Mr. Hughes, had co-authored an article entitled “Appraising Golf Courses For Ad Valorem Tax Purposes” for The Appraisal Journal in which he wrote (p.611) “A significant expense for any golf course and an expense that seems to be on the rise – is the real estate tax. . .”.

In analyzing the income approach in that article, Mr. Hughes wrote in connection with the capitalization of the real estate income stream (page 614) that

“. . .the next step is to deduct the real estate ad valorem taxes from fixed expenses”.
 “The NOI (net operating income) excluding, real estate taxes. . .is then capitalized based on a capitalization rate that is adjusted for the ad valorem tax. . . The capitalization rate is then added to the overall capitalization rate. It is calculated by noting the tax levy per dollar, multiplied by the assessment ratio”.

Essentially, both experts recognize the propriety of using a capitalization tax rate.

Petitioner’s expert, Mr. Dugas, performed a “gross” analysis by adding the taxes on the comparables, to the rent, and capitalized the tax rate to the rental by adding the

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“tax levy per dollar multiplied by the assessment ratio” of the “tax load factor”. Where the comparable was tax exempt, he added \$0.00 to the rent.

Mr. Dugas then converted that analysis into calculations which indicate the percentage rent if the property was analyzed on a “triple net” basis and which conversion produced a value in the range of that found under the assessor’s formula. It does not appear that there is a single comparable rental in either appraisal in which the landlord pays the taxes.

Although Respondent’s expert asserted that the percentage rentals should be adjusted for differences in tax rates, his percentage rents for Hempstead Country Club and Rockaway Hunting Club concerning golf, food and beverage and merchandise are exactly the same (Exhibit 5A) in each year, although the tax factors are substantially different (4.160 for Glen Head to 6.470 for Hempstead in 2008/09 and 4.720 for Rockaway to 7.093% for Hempstead in 2006/07).

Based on all the testimony and the exhibits and the submissions, the Court finds that the better practice is to add the actual tax contribution to the comparable leases and to capitalize the “grossed up” rent by applying a capitalization rate which includes a tax factor.

Based on the Petitioner’s appraisal, the percentage rents are as follows:

Golf:	25%
Food and Beverage:	8%
Merchandise:	10%
Other:	10%

Respondent did not perform a “gross” analysis, but found the following net rentals:

Golf:	22.5%
Food and Beverage:	7.5%
Merchandise:	7.5%

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Other: 7.5%

Petitioner converted his gross figures to net as follows:

Golf: 15%

Food and Beverage: 5%

Merchandise: 6%

Other: 6%

With respect to net rentals, the Respondents' expert's appraisal adjusted his rental of New York City municipal rentals from 29.3% to 33% for Clearview and from 18.5% to 26% for Douglaston. However, the basis of that adjustment was not explained, and there is no "grid" or sufficient evidence concerning adjustment, so computation and comparison of net percentage is not possible.

The Court adopts a 2% administration fee as per Petitioner.

Applying the Petitioner's percentage rents to revenues produces the following rentals, as per Petitioner:

	<u>Gross</u>	<u>Net</u>
1/2/2005(06/07)	\$914,696	\$567,254
1/2/2006(07/08)	\$928,685	\$575,924
1/2/2007(08/09)	\$942,821	\$584,686

With respect to capitalization rates, Petitioner applied a basic rate of 11% throughout while Respondent found 9.5%. Respondents data tends to share average capitalization rates of 11% for each year as a national average but the appraiser chose 9.5%.

Both appraisers agree that golf rounds have decreased since 2000 and that the risk of decreased demand, decreased revenue and decreased rentals has recently accelerated. However, the Court is bound to fix values for the years under review, and while today's

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events are relevant, the risk was not as high in the earlier years under review. The Court finds base capitalization rates of 9.5% for January 2, 2005, 9.5% for January 2, 2006 and 10% for January 2, 2007.

The Court accepts the assessor's formula as the proper approach for valuing each golf course. It produces a mathematically accurate finding, but even more importantly, avoids the necessity of finding an "average" or "typical" tax burden for all of the courses in the jurisdiction to determine whether or not any particular course is over burdened or under valued.

Use of the assessor's method and the capitalized tax rate permits an accurate value for each property independently, and produces a tax payment appropriate to that value.

The Court finds the dollar values for each year under review by adding the appropriate tax factor:

January 2, 2005	\$914,696	÷	[9.5% plus 7.08%]	=	\$5,516,863
January 2, 2006	\$928,685	÷	[9.5% plus 6.85%]	=	\$5,680,030
January 2, 2007	\$942,821	÷	[10% plus 6.37%]	=	\$5,759,444

Had the Court analyzed the values under the "triple net" approach, the result would have been approximately the same, as the Petitioner's "triple net" percentages, adjusted for the proper taxes and capitalized at the base capitalization rate without the tax load factor would be as follows:

January 2, 2005	\$567,254	÷	10%	=	\$5,672,540
January 2, 2006	\$575,924	÷	10%	=	\$5,484,990
January 2, 2007	\$584,686	÷	11%	=	\$5,315,327

The Court has applied the stipulated assessed value ratios as utilized by the parties. The correct assessed valuations in each year are found to be as follows:

	<u>Values</u>	<u>Ratio</u>	<u>Correct Assessed Value</u>
1/2/2005	\$5,516,863	.00935	\$51,583

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1/2/2006	\$5,680,030	.00960	\$54,528
1/2/2007	\$5,759,444	.00965	\$55,579

This shall constitute the decision, order, and judgment of the Court.

Settle judgment on notice.

Dated

15 July 2010

Stephen A. Bucaria
J.S.C.