How Fair is My Share?

Reviewing Property Tax Valuation Methodologies

In Retrospect: The Winter 1998 issue of Golf Business Canada ran an article providing owners with an overview of property assessment on the eve of reassessments in Ontario. Much has changed since this time with assessment authorities attempting to separate property values from sale prices of golf courses. Ontario courses are appealing their 6th annual assessment without resolution and the rest of the country awaits the outcome.

The valuation of golf courses can be as complex as the game itself and just like the game, never completely mastered by dealing with any task or shot in any one predictable way.

Also like with the game, technology continues to play a larger role as mass appraisal techniques are employed to streamline the assessment process.

Some assessment authorities have initiated a shift in assessment values in many jurisdictions based on the perception that the value of golf is rooted in land and buildings without adequate allowance for the incredible worth built up in the brand or intangible value over the last ten to 15 years.

DEFINING VALUE

The understanding of the valuation definition by jurisdiction is often why many valuators find difficulty in discussing cross-jurisdictional valuation concerns. In addition to terms, same or similar names or meanings can add further confusion to defining a true valuation model. For instance, Ontario relies on the "current value assessment" as defined in their Assessment Act, and British Columbia uses "actual value assessment", also defined by legislation and both are further defined through subsequent jurisprudence.

Golf courses are generally large tracts of land, often 65 hectares in size for an 18-hole facility. Their social and economic contributions to the municipalities in which they reside are important to the community's quality of life (preserving green space, healthy lifestyle, employment, tourism, community fundraising and of course contributing to the tax base).

Legislators often take these socially redeeming factors into account either directly, as Ontario did by adding a provision to the Assessment Act to enable municipalities to enter into long term agreements to fix assessments for those golf courses who commit to maintain their status; or they do it indirectly as in the Greenbelt Protection Act that accepts golf courses as a permitted recreational development to preserve green space, but nothing further.

Some American states such as Nevada have prescribed a level of taxation applicable to golf course operations to further enhance the attractiveness of this type of development while helping to ensure the longevity of this desirable land use.

THE 'RIGHT' WAY

Golf course assessments for property tax purposes are under the microscope in many provinces across the country and in many US states. "Getting it right" so to speak, becomes a relative term when establishing the basis on which property taxes are calculated by municipalities. Getting the right balance of the property tax burden sometimes by different classifications of taxpayers often becomes a political exercise to determine each class' "fair share" of the municipal tax burden as a whole.

The definition of the value assignment can make it very difficult to compare one jurisdiction to another without intense

scrutiny of both valuation methodology and terms of the definition often entrenched in the law within given jurisdictions.

There are, as we know, tangible and intangible assets involved in golf course sales, and the division of these assets may or may not be necessary depending on the definition of the valuation required. Certain jurisdictions may specify what approach is applicable or what components of value may not be considered.

For example, golf courses in South Carolina received substantial reductions in assessments when the State Legislature enshrined the practise of removing intangible assets from the assessed values of golf courses. This is one reason why the understanding of the definition is paramount in understanding the valuation approach to be used and how it is to be applied.

VALUING THREE WAYS

Assessment authorities generally rely on one of three methods of valuing property, or possible combinations thereof, including the Cost Approach, Sales Approach and Income Approach. The use of any of these approaches must be applied with a certain skill and expertise as to take into consideration all facets of the valuation assignment at hand and to comply with applicable legislation.

Within these three main approaches are numerous methods of application depending on the property. For example, the Sales Approach lends its self well to high volume transactions such as single family residential homes, as they are usually sold vacant, without any business considerations to be taken into account or encumbrances to be dealt with.

Multi-residential developments tend to use the Income Approach, using a method called the Gross Income Multiplier.

And many industrial property valuations rely on the Cost Approach by employing a principle of substitution. Variations of these approaches and methodologies are relied on for the valuation of golf courses.

THE ALL-INCLUSIVE SALE

For example, when looking at the Sales Approach, it is not as simple as taking a few sales of similar golf courses in a given area and imputing a valuation predicated on potentially unadjusted sales, without regard for the definition of the assignment. A myriad of components often make up the sale of a golf course.

With adequate examples, the Sales Approach is felt to be the best indicator of value in most market value-based jurisdictions. This may well be the case, provided the valuator knows how to account for what components may be involved in the sale of a golf course with its tangible assets of land, building and equipment and its conjoined intangible business assets.

In the vast majority of golf course sales, intangible assets of assembled capital and labour, memberships, tournaments, contact information, reputation and corporate events all form part of the sale. The 'hole-in-one' so to speak is how to consistently and fairly create this division of the sale price or total value where there is such a symbiotic relationship between the tangible and intangible assets.

RECENT HISTORY - ONTARIO

Citing a less than accurate result of a previously applied Cost Approach valuation compared to a Sales Approach using a ratio analysis, the Ontario Property Assessment Corporation (now known as the Municipal Property Assessment Corporation – MPAC) set new target values for golf course assessments. They then developed a new assessment model using gross income based on green fees.

On average, this new formula, applicable in the Greater Toronto Area for 2001 and 2002, lead to assessment values doubling outside Toronto city while reducing some city courses by two thirds.

For the 2003 property tax year and beyond, MPAC introduced a capitalized net income approach as a standard method for all Ontario golf course assessments-this again doubled on average the values previously set historically outside the GTA.

While the methodology has changed, the target values remained far too high (in our opinion).

According to MPAC, their valuations are below the sale value recorded on the Land Transfer Tax Affidavits used in their sales ratio analysis. This form, designed for remittance of transactional taxes owed, is ill-fitted for the highly complex breakdown of tangible and intangible assets included in the final sale price of a golf course business.

The Assessment Act in Ontario limits MPAC to placing an assessed value on land and buildings <u>only</u> for property tax purposes. Herein lies the rub. Golf courses are built on varying types of properties ranging from rural 'out of the way' places in remote areas often on flood plain or conservation land not suitable for any other purpose; to sometimes sought-after residential or commercial lands whose potential value exceeds what a golf course could ever be worth in terms of income generation. Golf courses, like commercial plazas, hotels and nursing homes, are also income generating properties.

CONCERNING POSITIONS

Where private courses are concerned, these should be valued on a similar basis to equivalent public courses. Not doing so risks assessing the membership's right of ownership, privilege, possible member equity and the like. Again the determining factor is what is permitted in the applicable legislative definition.

In jurisdictions where the tangible assets are the only elements to be considered in the valuations, one or both of two things must occur; there must be sales of only the tangible assets and/or a lease of only the land and building must be available. The proxy rent or lease approach can be useful in extracting the land and building component of an income stream based on typical market capitalization rates.

If we apply the same rationale as applied to any other commercial endeavor, a reasonable rental component should be extractable. If for example, a typical percentage rent of gross revenues was established from leases of golf courses, then one could capitalize this amount into a value for land and buildings. The capitalization rate may carry a premium for additional risk due to the seasonal nature or unpredictable weather, but nonetheless the approach should be similar because capital is said to be portable. An investor of capital does not necessarily care where they make their return, only that they make a reasonable return commensurate with the entrepreneurial risk.

Having said this, both the net operating income and the sales may need to be adjusted to arrive at a reasonable market capitalization rate, or at very least to compare to the market as a whole. Three valuations of the same golf course, occurring at the same point in time may be quite different if one is for the full market value of the operation (the 'golf shop'), one is for lending purposes and the final one is for valuation of the real estate only for some other purpose.

ACROSS CANADA

British Columbia uses both the Income and Cost Approaches depending on the type of course and the jurisdiction. Similar combined methodologies may exist in Alberta as there is no real province-wide standard. Valuations at the high end of the scale in larger population centres results in a tax burden higher than the rest of the country. Their separate definitions of 'actual value" changes what components of income are applicable.

Saskatchewan is in the process of revamping their assessment legislation to permit an Income Approach to valuation. The golf industry is working closely here with the Assessment Authority to ensure that historical fair values are maintained to the health of the industry. With 65 per cent of Saskatchewan courses run by municipalities, the potential for unfair operating advantages by non-taxpaying entities is a major concern.

Manitoba operates a reverse onus program that places the burden of proof on the municipality to show that their values have been correctly arrived at by equitable comparisons to other similar assessed properties. This suggestion has recently come up in Ontario in light of the Ombudsman's "Getting it Right" Report recently in the news. Interestingly enough, there is no requirement for accuracy, only that equitable comparisons were used.

Golf courses in Quebec have enjoyed a longstanding niche in the rural roots of their pastoral heritage. Viewed in a similar manner to the agricultural nature of turf development, assessments have been stable for quite some time.

The Atlantic Provinces have also been relatively issue free with the acceptance of golf course property taxation in balance with municipal expectations. In PEI the view is balanced by the strong tourism benefits and over-subscribed taxation revenue generated by the financial health of the 26 courses serving that small market, and the golf industry in Newfoundland is still developing. Assessments there are in line to support this burgeoning industry growth.

A BETTER UNDERSTANDING

In Ontario the current process begins with the annual submission of financial information, while MPAC applies some information to a pro forma model that calculates the value of your assessment. Your actual gross revenues are used against "normalized" industry standard expenses to produce a net operating income, and this income is capitalized into an asset value deemed to be your property assessment.

As suggested earlier, the problem with this methodology is the entire net income is capitalized, producing an inflated value.

The enormous database on file with MPAC may be reasonably statistically accurate to provide percentage share of allowable expenses based on all of the Ontario golf industry, but applying that information correctly based on particular markets can provide certain challenges. The concern here is the weighted influence of affluent urban markets tending to skew results and valuation then not individually applying to smaller markets in rural settings.

The nature and complexity of golf course valuation in Canada presents many challenges for all parties nationally. This is but an overview of the factors influencing current practices. It remains of utmost importance that the NGCOA Canada reflect industry insight to ensure equitable valuations of golf courses that result in only our fair share of the property tax burden in each region.

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