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NewsLinks

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Conservation Easements for Golf Courses - Fact or Fantasy- Part II

By William E. Ellis

The Amount of the Charitable Deduction

Meeting the statutory and regulatory requirements is just the first step. The next step is to determine the fair market value of the easement which represents the amount of the charitable deduction. *It is very possible to make a qualified conservation easement yet not derive a charitable contribution deduction as the restriction may have little or no reduction in value to the property and may, in fact, actually enhance the value of the property or other properties owned by the donor*. The regulations specify that the value is based on comparative record of sales of such easements. If a substantial record of comparable sales does not exist (and they generally do not) the value is equal to the difference between the fair market value of the property it encumbers *before* the granting of the restriction and the fair market value of the encumbered property *after* the granting of the restriction, *less* the increase in fair market value of other property owned by the donee even if not contiguous.

This fair market value determination, a "before" and "after" estimation, must follow traditional appraisal principles. It also may be comparable to condemnation valuations. Keep the thoughts simple -- the documentation needs to clearly demonstrate that something of true value today has been relinquished. It must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent restriction, would in fact be developed, as well as any effect from zoning, conservation, or other laws that already restrict the property's highest and best use. Zoning, conservation, or other laws may present significant obstacles to this valuation. In the case of a golf course, absolute or practical hurdles may exist to develop the property for other uses with a higher market value – these needs to documented in every case. The locality of each property will have different facts to consider. A simple discounted cash flow calculation of the potential proceeds from forgone hypothetical development of the property will not meet the valuation principles enumerated in the regulations. A conservation easement may also be part of the negotiations to obtain zoning or other entitlements to meet the developer's needs. In this case a "quid pro quo" issue is present and the value may have been received in the zoning or entitlements obtained. Thus, the easement restriction may have little or no *net fair market* value at the time of contribution.

Conclusion

The charitable conservation easement may bring significant income tax, and potential real estate tax, benefits to certain owners of golf courses and related properties. Keep in mind that the easement may help reduce property taxes even if an income tax deduction is limited. From a charitable deduction standpoint, conservation easements on golf courses are a challengeable area. Each situation must be reviewed in detail with the enumerated conservation requirements and valuation principles. As a simple rule of thumb, a real estate person should truly believe conservation principles have been met; a significant public benefit is present *and* a future value measurable in today's dollar.

Continued on Page 2.

Inside this Issue

Conservation Easements, Continued

A presentation that presents huge tax benefits without truly giving up something of value is likely to be too good to be true. It is highly advisable to use qualified professionals practicing in the traditional conservation easement arena. These legal and tax professionals, land trusts and conservation organizations truly understand the principles involved and can provide balanced advice.

Any and every conservation easement can be challenged by the IRS – both the qualification for and the amount of the contribution. The number of IRS audits and the issues raised ebb and flow based upon the focus of the IRS, examination resources and even the specific examiner involved. Conservation easements on golf courses could receive scrutiny given the present state of "tax shelter" focus and we are aware of some golf course easement related examinations in process. Each donation will have to be separately justified and representations that other contributions have not been challenged or have been accepted on audit will not provide any protection against the assessment of interest and penalties if your easement is challenged. Penalties can be onerous if a substantial overstatement of value is claimed. *A promoter who requests conditions of confidentiality should be immediately suspect*. First, the matter is not proprietary or secret, and perhaps more importantly, this will likely make any contribution a "tax shelter" requiring substantial disclosure, promoter maintenance of lists and exposure to additional significant penalties under the newly enacted tax shelter laws and regulations.

Just 4 years ago the IRS deemed the golf course owners industry to be "noncompliant" with many IRS pronouncements, most particularly their age-old position disallowing deductions for depreciation. The IRS was poised to push for industry-wide audits coordinated within IRS Districts. Through a carefully planned and executed plan, the industry responded with facts and reasoned positions that resulted in the IRS and Treasury agreeing with the industry's position that a substantial portion of modern golf course construction costs are eligible for depreciation. A new published revenue ruling has been issued, District-led audits of the golf industry have not materialized and the industry has made efforts to follow the new rules. Likewise, conservation easements should be based on a proper analysis of facts and reasoned positions. Positions that seem to be too good to be true usually are and the adverse consequences can be painful to the taxpayer and the industry.

Our advice in this article is based on the facts as stated and on authorities that are subject to change, retroactively and/or prospectively.

__William E. Ellis__ served as practice leader of the KPMG Atlanta tax practice for the real estate industry until starting his own firm William Ellis & Assoc. in 2003. He has 30 years of experience in public accounting and has exclusively provided tax services to real estate industry clients since 1984. He performs substantial tax planning services for golf course owners and developers.

<u>Acquisition Opportunities</u>

GPA has been retained as the exclusive marketing agent for the following acquisition opportunities:

<u>Beacon Hill Golf Club, Leesburg, VA</u> – Upscale Private Club (27 holes) designed by Johnny Miller in affluent area west of Washington, DC, available for acquisition.

<u>Pebble Creek Country Club, Greenville, SC</u> – Semi-Private Club (36 holes) designed by Tom Jackson available for acquisition. Possible development opportunity for 9 of the 36 holes (w/ Furman & Co).

<u>Three Little Bakers Country Club, Wilmington, DE</u> – Semi-Private golf course facility (18 holes) with clubhouse. Also, approved, 20 unit condominium development opportunity and dinner theatre facility (dinner theatre business not included) situated on 8 acres of commercially zoned ground (suitable for development), available for acquisition.

<u>Greystone Golf Club, Dickson, TN –</u> 18-hole daily fee golf course with clubhouse and maintenance facility, designed by Mark McCumber. The property includes a 7,500 SF clubhouse (plus lower level), 7,500 SF maintenance facility and is situated on 203± acre site. Call GPA Associate & TN Broker, Mac Harris @ 252-249-1560

<u>Whitetail Golf Course, Mercersburg, PA</u> – Daily fee golf course facility (18 holes) with practice area, maintenance facility and maintenance equipment, adjacent to Whitetail Ski Area with hotel development opportunity available for acquisition.

UNDER CONTRACT

Contact Larry Hirsh at 800-775-2669 or 717-652-9800 for more information.

Focus On…

In this issue of NewsLinks, we introduce a new column, which will profile either an issue, a market of interest or a particularly interesting property encountered in our practice. While maintaining appropriate confidences, we hope to make this a sort of case study that will allow our readers (and us) a different and hopefully informative perspective on particular issues or segments of the golf industry.

An area we have considerable recent exposure to is the "second" club market. For definition purposes, a "second" club would be defined as one whose members typically belong to another club in their hometown. In some cases the second club can be in the member's hometown but typically is a retreat or winter destination.

As noted in the "Practice Tee" section of this issue, we have recently provided appraisal services for the prestigious Caves Valley Golf Club in Baltimore, a Tom Fazio masterpiece that was host to the US Senior Open in 2002 and at The Golf Club of New England in Portsmouth, NH, an Arnold Palmer design of considerable appeal not far from Boston. We have also been fortunate to work at many other "second" clubs and learned a great deal.

A brief look at membership levels at the "national" clubs surveyed during these assignments shows the following trends:

Membership Trends – "National Clubs"

	# of Members	# Capacity	% Capacity
High	2,000	2,375	84.21%
Low	113	250	45.20%
Average	404	507	79.66%

The 42 clubs surveyed (either by Golf Property Analysts or by Greenberg Traurig, P.A.) represented locations around the country and typically ranged from maximum membership caps of 200 to 450 members per 18 holes of golf. Some had associated residential developments. Most of these clubs were beyond their initial sellout period, indicating unused market capacity in this segment.

Pricing ranged from below $10,000 to in excess of $325,000 for memberships with this wide range typically depending on location, with major metropolitan and upscale resort areas demanding the highest fees. For instance, clubs located in close proximity to New York and Los Angeles, along with clubs in South Florida, trendy Rocky Mountain resorts and the wine country of Northern California seemed to command the highest membership prices. Accessibility seems to contribute to a club's pricing, but not necessarily to its ability to develop membership, in that there are some clubs in difficult to reach locations with full memberships but at lower pricing than those near major transportation centers.

Seemingly because of limited membership, high costs and the demands for perfection of the clientele, dues at this type of club range as high as $1,750 per month. Ownership structures run the gamit from equity to non-equity with most every option in between. This includes a variety of refundability options for those non-equity clubs. Another trend is that some clubs are modifying their ownership structures as they respond to their unique operating issues and membership profiles.

In most of the clubs observed, one common denominator was that the golf course was designed by a "marquee" architect. Included in this list were names like Jack Nicklaus, Tom Fazio, Pete Dye, Arnold Palmer, Rees Jones and others. Most (but not all) of the clubs observed were either part of or associated with a residential development.

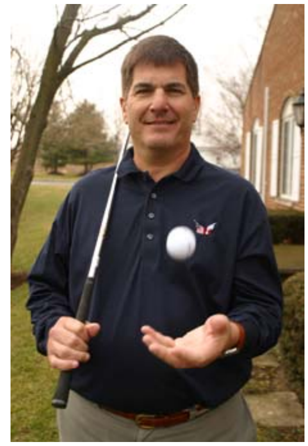
In conclusion, our brief look at the national upscale club market shows:

- That there is unused capacity and available memberships
- Pricing is very sensitive to location
- About one third of the clubs surveyed are fully subscribed
- Even clubs that appear to be "well heeled" are experiencing some financial challenges.
- Membership pricing is NOT as volatile as local clubs, with "second" clubs tending to maintain stability in this area.

Next issue look for a focus on a geographic market that's kept us quite busy of late, The Delaware Valley surrounding Philadelphia (PA, NJ, DE).

Linking Up -

By Larry Hirsh



Often, I'm asked how we value golf courses that are losing money. This particular question seems more relevant now as many clubs and courses are struggling financially. Since we have recently been called upon in many instances to provide valuation, consulting or brokerage services, I thought I'd devote this column not only to what such properties are worth but some of the reasons for failure that I've observed and how to avoid them.

First, let's discuss the issue of what a property is worth:

Buyers, especially in a down market, typically contend that historical cash flow is the only true measure of value. If that were true, many properties would be worthless and the market has proven otherwise - even those with negative cash flows have value. While a property's history is a major contributing factor to its value, it is clear that external market factors and quality of management play significant roles as well.

Many properties are located in very competitive markets that will require time to "correct" either from the disappearance of some courses or from the absorption of facilities into the market. This time element is often the critical factor in evaluating whether an opportunity exists or not. Accordingly, a property with negative cash flow that can reasonably be expected to make money in the future will have value that is calculated through use of a discounted cash flow analysis. Obviously, it is critical that the market analysis leading to potentially positive cash flow projections be realistic and objective. If it is, a value estimate can be derived that is reliable. If the property has no real potential for a positive cash flow, then it may be time to consider alternative uses.

Recently, our firm has been involved in several "troubled" properties as consultant, appraiser and broker. Given the current strength of most real estate markets, there is often an alternative opportunity **perceived** for the underlying land and its development. Often, real estate developers actively seek out golf course properties. However, since some properties contain restrictive covenants precluding development, these "troubled" courses need to find ways to succeed within a golf environment.

Why is it that some clubs succeed while others fail, even in the same market? Here are some of the observations I've made over the years.

- **Planning** – Many golf courses are ill-conceived and poorly planned. Objective market analysis is overlooked in favor of the intoxication of getting a project completed.
- **Patience** – Golf courses (especially new ones) often require patience to mature. Many private clubs have failed and become struggling daily fee courses because developers or members became scared and reduced prices or allowed daily fee play.
- **Mismanagement** – Golf courses are very management intensive. From the people who meet, greet and serve the clientele to those responsible for marketing and maintenance, everybody has to be on the same page and know what the "team's" goals are. Member-owned clubs often suffer by simply micro-managing and not having a plan that professional staff can follow. Continued on Page 5.

Linking Up, continued.

- **Misspending** – One area I have seen a great deal of lately is courses that simply cost too much to build. We've been involved in courses that cost between $10 million and $25 million to develop that will ultimately bring anywhere from $.20 to $.50 on the dollar when sold. In some cases it's not paying attention. In others, it can be fraud. Conversely, I have also seen many courses where developers lost sight of what their goals were and simply didn't spend money where they should have. Golfers are quite demanding and usually notice "short-cuts".

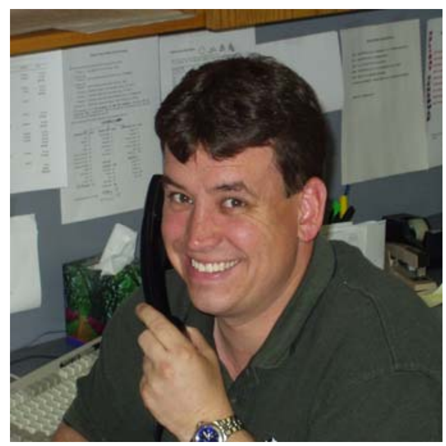
- **Management by Committee** – Decisions need to be made by knowledgeable professionals in a timely manner. Club committees often cannot respond quickly enough to deal with some problems. Sometimes, this occurs because of the process and sometimes because of "political" differences. The most efficient clubs are those run by "dictators" who have the best interests of the club at heart and who are willing and able to take the time (and the heat) to run the club.

After looking at all these reasons for failure, it's easy to see that in many, if not most cases, the failure was due to a people problem. Thus, valuing a course that's losing money is often a problem of analyzing how the club can be repositioned or managed more effectively and then planning for recovery over time.

The bottom line is that certainly most golf courses, even with negative cash flows have value. It's up to the owner to maximize that value through objective market analysis, insightful management and good marketing.

Shaun Henry
Joins Golf Property Analysts Team

Shaun A. Henry, formerly golf course superintendent at Wren Dale Golf Club, Hummelstown, PA has joined Golf Property Analysts to combine his golf course agronomic experience with an interest in golf course real estate. He will assume the position of staff appraiser/consultant with GPA, bringing additional expertise to the firm's growing consulting practice and contribute his unique background and expertise to appraisal and consulting assignments.



Shaun is a graduate of Delaware Valley College with a Bachelor's Degree in Agronomy and Environmental Science and an 11-year member of The Golf Course Superintendents Association of America.

Henry has over 12 years of golf course industry experience at several upscale clubs including Wilmington Country Club, Huntingdon Valley Country Club and Congressional Country Club where he served as Assistant Golf Course Superintendent. His professional highlights include being part of the team that hosted the 1997 US Open and overseeing and managing construction and grow-in of a new upscale, member owned golf club designed by Hurdzan-Fry Golf Course Design and built by Landscapes Unlimited, Inc.

Wyoming Valley Country Club, a private, A. W. Tillinghast designed golf course in Wilkes-Barre, PA, recruited Mr. Henry to direct golf course operations in 1998. He was responsible for maintenance of the 18-hole golf course as well as upgrading agronomic programs, equipment, staff, and maintenance facilities. During his tenure at Wyoming Valley Country Club, Mr. Henry worked closely with the Greens Committee and Board of Directors to complete many renovation projects including, bunker reconstruction, conversion to bent grass fairways, pond reconstruction and a tree management program.

While serving as Construction and Grow-in Superintendent at Wren Dale Golf Club near Hershey, PA, Mr. Henry served as the owner's representative for all aspects of construction and grow-in of the Championship, Hurdzan-Fry designed golf course. His responsibilities at Wren Dale included, coordinating the efforts of owners, architects, engineers, contractors, inspectors and staff. Mr. Henry also instituted an extensive quality control program, assembled a professional golf course maintenance team, introduced maintenance standard guidelines, and developed a detailed grow-in budget and equipment acquisition plan.

Henry brings vast experience to the field of golf course appraisal and consulting to enhance the professional services of Golf Property Analysts for its many clients and will be contributing relevant articles to NewsLinks..

Shaun Henry may be reached at 717-652-9800 or at shenry@golfprop.com.

The Practice Tee

- **Investcorp Realty, Inc.**, of New York, NY retained **GPA** to provide a market value appraisal of the **Emerald Dunes Golf Club** in **West Palm Beach, FL**.
- **GPA** has been retained by **Mashantucket Pequot Tribal Nation**, owners of Foxwoods Resort to provide a market value appraisal of the **Lake of Isles Golf Club** in **North Stonington, CT**.
- **Caves Valley Golf Club** recently retained **GPA** to provide market value appraisal services for the club, in **Owings Mills, MD.**
- **Woods & Aitken, Attorneys at Law** of Lincoln, NE recently retained **GPA** to provide litigation support services in connection with **Big Sugar Golf Club, Pea Ridge, AR**
- **Taylor & Keane** recently retained **GPA** to provide ad-valorem assessment evaluation and market value appraisal of **The Golf Club of New England, Portsmouth, NH.**
- **Medallist Developments** recently retained **GPA** to provide a market value appraisal for **Savannah Quarters Golf Club** near **Savannah, GA.**
- **United Water Company** recently retained **GPA** to provide market value appraisals for their **Valley Brook Golf Club and Emerson Golf Club** properties in **Bergen County, N**