Valuation of Common Areas for Property Tax Purposes

By James M. Susa

James M. Susa focuses on the tax valuation of common areas within a planned community, noting that, while most courts have recognized that an easement granted to benefit one estate to the detriment of another estate may adversely impact the value of the burdened estate so as to render that estate of little value, not all have embraced this concept, and so the litigation continues.

Introduction

All property, unless exempt, is valued for the purpose of imposing a property tax. The value generally is based upon the market value of the property. Market value is defined as the most probable price a knowledgeable buyer would pay to a willing seller. A unique problem arises when the property being valued is not often sold in the market. One such property is a common area within a planned community. This article will focus on the valuation for tax purposes of common areas within planned communities in various states where case law or statute addressing such valuation exists.

A Majority of Courts Hold Common Areas Have Nominal Values

By most definitions, common areas are parcels located within planned communities which are owned by a homeowners' association and provided as amenities to individual homeowners within the community. Homeowners maintain "easements of enjoyment" for recreational or open-space use of the common areas under the community's covenants, conditions, and restrictions. Common areas are often used as inducements by the original community developer to entice prospective buyers to locate and have homes built,

James M. Susa is of counsel with Snell & Wilmer L.L.P. in Tucson, Arizona.

by the developer of course, within the community. Thus, it is not uncommon for the developer to spend several million dollars to construct common areas within a community. In higher-end communities, the common areas often include swimming pools, tennis courts, and clubhouses with sufficient space for indoor gyms, wedding receptions, banquet halls, and community member meetings.

The problem, in the property tax context, is how to determine the value of these common areas. Assessors, required by law to determine a market value, have confronted the issue as to the proper way to value common areas for many years. Extensive litigation has resulted in fairly consistent results for over a century. These decisions typically hold that easements on the common areas, as well as other factors, including zoning and land use restrictions, which in many instances require recreational or open-space use, render common areas with little or, in assessor terminology, "nominal" value. A typical nominal value is $500, irrespective of common area size or composition (*i.e.*, a clubhouse or a community signage landscaped space).

> County assessors, and some courts, are reluctant to conclude that lavish accommodations for the exclusive use of neighboring owners should not have a taxable value.

The earliest cases addressing the nominal value of common areas are from New York State. In 1910, the New York Court of Appeals held that a park subject to easements restricting its use for the benefit of surrounding lots had a nominal value.[1] The court found that the surrounding lots were benefitting from such easements, resulting in a higher value for those lots, a resulting increase, which, in the aggregate, met or exceeded the value of the park. The court applied a longstanding and fundamental legal principle—where an easement is carved out of one property for the benefit of another, the value of the servient estate is thereby diminished, whereas the value of the dominant estate is increased. The court also found that the park could not be sold for any sum because any purchaser would have no right to enjoyment, as the property would be held for the enjoyment and use of the surrounding property owners. The court's reasoning applies whether the property at issue is merely a park or has substantial improvements. The determination of value is based upon the existence of an easement that burdens the property, not on for what purpose the property is being used (as long as it is a common area).

Two decades later, in 1933, the *Wells* holding was used to substantiate the claim that a park owned by a corporation for the benefit and use of individual lot owners in a development had nominal value. The court again found that the park's value, as a result of easements granted to owners within the development, had shifted to the dominant estates of the owners, resulting in a diminution of value for the park itself.[2]

Similarly, other state courts have reached the same conclusion. For instance, the Oregon Supreme Court has held that a golf course used by neighboring property owners, and subject to zoning restrictions and other use and maintenance restrictions, was properly classified as a recreational area. The court reasoned that these restrictions are "practical considerations" that must be taken into account. After factoring such "practical considerations," the court concluded that the property had no cash value.[3] Other factors, however, seemed to be relevant in the court's determination, including evidence that the golf course operated at a loss and, further, the taxpayer had previously offered to donate the golf course to the city, which was rejected. That is, even in the absence of finding that use and legal restrictions affect the value of property, the court could easily have determined that the property had little economic value, evidenced in part by the city's refusal to take title at no cost.

Additionally, the Maryland Court of Appeals has reasoned that the combination of a grant of easement for recreational use and the imposition of restrictions against disposition and improvements deprived a beach property, as the servient estate, of whatever value it might have otherwise had.[4] There, a residential subdivision on a river and bay was assessed at full cash value. The court determined that any value was "exclusively and permanently" attached to the benefitted neighboring lots. Nevertheless, in establishing the beach property's value, the court concluded the beach property to be worth 40 percent of the full cash value originally determined by the assessor, a somewhat surprising result in light of the court's analysis and reasoning.

Maryland, in particular, illustrates the battle that has long taken place between property owners and county assessors. Under a logical analysis of the issue, it is undeniable that easements, use restrictions, and zoning requirements have an impact on a property's value and, in particular, market value. If market value is determined by a bargaining of willing and able market participants, then how can such restrictions not affect value? That is, what buyer would willingly pay "full price" for a property where such owner may not restrict use of the property, charge a fee for use or, in some circumstances, even utilize the property. However, county assessors, and some courts, are reluctant to conclude that—even in the face of a determination that the market value of the property is severely diminished—a beach property, or other lavish accommodations for exclusive use by neighboring owners, should not have value and, as a result, pay no property taxes.

The Kansas Supreme Court, with its decision in *Quivira Falls Community Ass'n v. Johnson County*,[5] may also have been conflicted. There, the property consisted of common areas that included a swimming pool, tennis courts, a clubhouse, and picnic areas. The property owners asserted that the common areas became "worthless" due to restrictions on the common areas of a planned development and that the value of the common areas could be included in the appraisal and valuation of the individual property. While acknowledging that other courts had held similar common areas to be without value, the court held that the association failed to present any testimony or evidence as to value. As a result, the court upheld the assessor's market-derived value. The lesson from Kansas is that the burden is upon the property owner to produce competent evidence as to value and, in this case, the property owner merely asserted the value of the common areas was zero, which did not prove to be persuasive to the court.

On the other hand, other decisions and subsequent legislative changes illustrate that not all states are equally as conflicted. The Washington Supreme Court, for example, held that a golf course was so restricted by zoning and conveyance restrictions regarding use and nonalienability that "its ownership was of no benefit or value" and, thus, had zero market value.[6] The court cited to the *Tualatin* decision from the Oregon Supreme Court in 1970 as persuasive authority.

Likewise, the New Hampshire Supreme Court found that common areas consisting of a manmade lake, a community lodge, a golf course, a ski slope, a marina, ball fields, tennis courts, beaches, swimming pools, and other recreational areas of a homeowners' development was so encumbered with easements, despite the revocable nature of the easements, that it had no value.[7]

Also in 1985, the Virginia Supreme Court examined the value of subdivision common areas consisting of a lake, golf course, and clubhouse. The court held that "where the servient estate is burdened by an easement for the dominant estates, then, for property tax purposes, the value of the servient estate is to be reduced and that of the dominant estate increased in accordance with the corresponding burden and benefit."[8] The court remanded the case with instructions for an assessment of the common areas at a nominal amount.[9]

> Where a servient estate is burdened by an easement for the benefit of dominant estates, then, for property tax purposes, the value of the servient estate must be reduced and that of the dominant estates increased, in accordance with the corresponding burdens and benefits.

In 1989, the Arizona Supreme Court ruled that common elements consisting of recreation centers, golf courses, and a bowling alley owned by the homeowners' association that had been valued at replacement cost were valued in excess of their market value because the assessor had failed to consider the use limitations on the property in the valuation formula.[10] The common areas of the adult retirement community were conveyed to Recreation Centers with a restrictive covenant stating that the properties must be used "for the purpose of operating and maintaining a community center and recreational facilities without pecuniary gain or profit, for the benefit of property owners." The court held that recreational-use restrictions must be taken into account when assessing the value of common properties. The court remanded the case to the trial court for a determi-

nation as to what the value of the property would be given the use restrictions. After the remand, the Arizona Legislature resolved the valuation issue by enacting Arizona Revised Statute Section 42-13403(B), setting a value for all common area parcels at $500, irrespective of the use within the planned community.

In 2008, the Connecticut Supreme Court held that common areas with easements and restrictions should be assessed at no more than nominal value.[11] The case involved an association formed for the purpose of "maintaining, preserving, and protecting commonly used property within Breezy Knoll," a private residential community.[12] Although the association held title to the common areas, the deeds transferring ownership to the association subjected the common areas to extensive easements and restrictions that included: (1) residents, as members of the association, shall have continuous access to the common areas; (2) the association is required to own and maintain the common areas for the members; and (3) the easements and restrictions "shall be operative and binding on all future owners of any interest … for a period not exceeding twenty one years after the death of the survivor of all the now living persons who shall together constitute the original members of the association."[13] Finally, the easements and restrictions could not be altered, amended, revoked, terminated, or released from the common areas without the written consent of at least two-thirds of the Breezy Knoll property owners.[14]

The court in *Breezy Knoll* held that, in light of the extensive easements and restrictions precluding the sale of the properties and the unanimous testimony of appraisers that the association members were not likely to consent to the release of the easements and restrictions, the properties should be valued at a nominal amount.[15] The court used the guiding principle that "when an easement is carved out of one property for the benefit of another the market value of the servient estate should therefore be assessed accordingly."[16] The court reasoned that a property so encumbered with easements that no use can be made of it shall pay no tax.[17]

The court in *Breezy Knoll* relied heavily on *Lake Monticello Owners' Ass'n v. Ritter*,[18] where the common areas of a residential community were deemed so burdened by an easement for the benefit of the homeowners that, for tax purposes, the common areas were reduced to a nominal amount. The court also relied on *Waterville Estates Ass'n v. Campton*.[19] In *Waterville Estates,* the common areas of a condominium development were subject to restrictions in a recorded declaration, which required approval from two-thirds of the homeowners to release the restrictions. The court in that case held that the properties were so "severely burdened" by the restrictions that the value should be reduced to nominal value.

Other Cases Have Held Common Areas Are Not Given Nominal Values

Despite the long history of cases holding that common areas should be valued for property tax purposes at nominal amounts, there are several cases which do not apply this principle. However, in examining the holdings in those cases, the decisions usually turned on some particular defect in the litigation (like the failure to present any evidence of value), not on the rejection of the principle that common areas are so burdened by an easement for recreational use that they are without value.

For instance, in 1987, the Washington Supreme Court decided *Sahalee Country Club v. Bd. of Tax Appeals*.[20] This case involved a country club that managed golf courses, used by neighboring residents, at a financial loss. The golf course was shown to have a substantial market value despite its use by neighboring residents because it was voted one of the best golf courses in the United States. The court held that this golf course was not entitled to an assessment of nominal value despite the fact that the court agreed with *Twin Lakes* (discussed above) because this case is distinguishable from *Twin Lakes.* The court reasoned that this golf course did not have extensive limitations to make it valueless since it was open to the general public, and testimony was provided that investors would purchase the golf course at a premium price. The key difference between *Twin Lakes* and *Sahalee* was that the easements upon the two golf courses were materially different, rendering the one in *Twin Lakes* so burdened as to be bereft of market value while the course in *Sahalee* had less intrusive easements, making it highly valuable.

In *Radisson Community Ass'n, Inc. v. Long*,[21] the New York Supreme Court, Appellate Division, held that common areas did not have nominal value, but for procedural, not substantive, legal reasons. First, the common areas owner that sought a reduction in value to a nominal value put much higher values on

the actual appeal forms filed with the Board of Assessment Review. Under the administrative rules, the value could not be reduced below the amount put on the form. Secondly, the common areas owner's appraiser's testimony that each common area parcel was worth $1 was stricken from the record because the appraised value was lower than that put on the appeal form. Thus, under the procedural rules, the common areas owner failed to provide any evidence in support of its assertion that the common areas had a nominal value. A lesson to those preparing property valuation appeals is to always be sure to carefully follow the local rules of procedure.

Most other cases holding that common areas have non-nominal values fall into the same category as *Radisson*, with the common areas owner failing to either follow the rules for appealing value or not introducing any competent evidence, other than just the bald assertion that the property has a nominal value.

Some State Legislatures Have Resolved the Valuation Question

As mentioned above in the discussion of the *Recreation Centers* case in Arizona, the Legislature enacted a statute declaring that common areas shall be valued at no more than $500 per parcel.[22] After this enactment, the only open question revolved around what exactly constituted a common area under the statute.[23]

Further, Illinois statutorily provides that common areas used for "recreational or similar residential purposes and which are assessed to a separate owner and are located on separately identified parcels shall be listed for assessment purposes at $1 per year."[24] The statute applies to residential properties that are part of a development "which includes the right, by easement, covenant, deed or other interest in property, to the use of any common area for recreational or similar residential purposes."

Conclusion

For over 100 years, various courts have recognized the basic real property law principle holding that easements granted to benefit one estate and to burden another estate impact the value of the burdened estate. This impact can be so significant as to render the burdened estate of little or nominal value. Not all states have embraced this concept, and litigation continues in some states as to the application of this principle.

Endnotes

1 *People ex rel. Poor v. Wells,* 124 N.Y.S. 36, 139 A.D. 83 (N.Y. App. Div. 1910).
2 *Crane-Berkley Corp v. Lavis,* 263 N.Y.S. 556, 238 A.D. 124 (N.Y. App. Div. 1933).
3 *Tualatin Development Co. v. Department of Revenue,* 256 Ore. 323, 473 P.2d 660 (1970).
4 *Supervisor Assessments v. Bay Ridge Properties, Inc.,* 270 Md. 216, 310 A.2d 773 (1973).
5 *Quivira Falls Community Ass'n v. Johnson County,* 230 Kan. 350, 634 P.2d 1115 (1981).
6 *Twin Lakes Golf and Country Club v. King County,* 87 Wash.2d 1, 548 P.2d 538 (1976).
7 *Locke Lake Colony Ass'n v. Barnstead,* 126 N.H. 136, 489 A.2d 120 (1985).
8 *Lake Monticello Homeowners Ass'n v. Ritter,* 229 Va. 205, 327 S.E.2d 117 (1985).
9 *Id.* at 211.
10 *Recreation Ctrs. v. Maricopa County,* 162 Ariz. 281, 782 P.2d 1174 (1989).
11 *Breezy Knoll Ass'n, Inc. v. Town of Morris,* 286 Conn. 766, 946 A.2d 215 (2008).
12 *Id* at 768.
13 *Id.* at 769-770.
14 *Id.*
15 *Id* at 786.
16 *Id.* at 777, citing *Pepe v. Board of Tax Review,* 41 Conn. Supp. 457, 464, 585 A.2d 712, 719 (1990).
17 *Id.* at 780, citing 1 J. Bonright, Valuation of Property (1837) p. 496; see also, *Supervisor of Assessments v. Bay Bridge Properties, Inc.,* 270 Md. 216, 222, 310 A.2d 773, 779 (1973) (easements and restrictions deprived the servient estate of whatever value it may have otherwise had).
18 *Lake Monticello Homeowners' Ass'n v. Ritter,* 229 Va. 205, 327 S.E.2d 117 (1985).
19 *Waterville Estates Ass'n v. Campton,* 122 N.H. 506, 446 A.2d 1167 (1982).
20 *Sahalee Country Club v. Bd. of Tax Appeals,* 108 Wn.2d 26, 735 P.2d 1320 (1987).
21 *Radisson Community Ass'n, Inc. v. Long,* 809 N.Y.S.2d 323, 28 A.D.3d 88 (2006).
22 A.R.S. § 42-13403(B).
23 *See Sun City Grand Community Ass'n v. Maricopa County,* 216 Ariz. 173, 164 P.3d 679 (App. 2007) (held the clubhouse, golf and snack shack, and surrounding areas to be common areas under the statute and thus entitled to the $500 per parcel value).
24 35 ILCS 200/10-35(a).