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Florida Court of Appeal Rules against Rushmore Approach in Disney Resort Decision

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Abstract

A June 2020 decision issued by the Florida Fifth District Court of Appeal could have far-reaching implications for the market valuation of hotel properties throughout the United States. The appellate court upheld a lower court's decision rejecting the valuation methodology, the Rushmore Approach, utilized by the Orange County Property Appraiser in its assessment of the Disney Yacht & Beach Club Resort. It was 1978 when Rushmore posited the first accepted methodology for separating income attributable to business (intangible asset) from income attributable to personal property from the entire income stream of a lodging facility.

Introduction

On June 19, 2020, the Florida Fifth District Court of Appeal issued a decision that could have far-reaching implications for the market valuation of hotel properties throughout the United States. The case, *Rick Singh, As Property Appraiser*, *vs. Walt Disney Parks and Resorts US, Inc*., *et al.,* involved a tax appeal of the 2015 assessment of the Disney Yacht & Beach Club Resort in Orlando, Florida (*Singh vs. Walt Disney* June 2020). The appellate court reversed the trial court's assessment of property value based upon lack of evidence; however, it did uphold the lower court's decision to reject the valuation methodology, the Rushmore Approach, utilized by the Orange County Property Appraiser for its assessment of the Disney Yacht & Beach Club Resort.

In a 1978 monograph, Rushmore posited the first accepted methodology for separating income attributable to business (*intangible asset*) and income attributable to personal property from the entire income stream of a lodging facility (Rushmore 1978). The procedure, which to this day continues to reflect the thinking and actions of hotel-sector market participants, has been termed the Rushmore Approach.

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The appellate court ultimately agreed with Disney and the lower court by categorically rejecting the challenged assessment methodology utilized by the property appraiser in its valuation of hotel properties. Although the Rushmore Approach is used by other Florida county property appraisers, the appellate court opinion declared that, "the Rushmore Approach violates Florida law because it does not remove the nontaxable, intangible business value from an assessment."

Highlights of the appellate court's written decision are as follows:

Rushmore Includes Value of Intangible Business Assets. "We agree with the trial court that Appraiser, by using the Rushmore method, impermissibly included the value of Disney's intangible business assets in its assessment. The Rushmore method requires franchise and management fee expenses to be deducted from the total property income, which purportedly removes the business value from the assessment. However, it does not provide for adjustments to the gross business income for intangible business value prior to making those expense deductions. Jones testified that the deductions for franchise and management fee expenses removed all intangible business value, such as cash/working capital, favorable operating licenses, assembled workforce, brand, copyright, and goodwill. By taking a percentage out of a business's net income for management and franchise fee expenses, without first removing intangible business value from that gross income stream, the Rushmore method does not remove all business value from an assessment; to the contrary, we conclude that the Rushmore method ignores the fact that an intangible business value may be directly benefiting a business's income stream." (*Singh vs. Walt Disney* June 2020)

Rushmore Does Not Remove Nontaxable, Intangible Business Value. "Accordingly, we conclude that the Rushmore method violates Florida law because it does not remove the non-taxable, intangible business value from an assessment. Thus, the trial court did not err in rejecting Appraiser's ancillary income figure, derived using the Rushmore method." (*Singh vs. Walt Disney* June 2020)

Reassessment Would Include Nontaxable Assets. "On remand, Appraiser should not reassess the Property using the Rushmore method. As explained, Appraiser's assessment of ancillary income, conducted using the Rushmore method, failed to present competent evidence as to deductions for the intangible business value of Disney's operations on the Property. If Appraiser conducts a re-assessment using the Rushmore method, its assessment will yet again include these non-taxable assets." (S*ingh vs. Walt Disney* June 2020)

Opinion Reverses Trial Court. "While we would have preferred drafting an opinion that would resolve the parties' dispute, we find the record evidence is insufficient for us to do so. Accordingly, we reverse and remand to the trial court, with instructions that it remand to Appraiser for a reassessment of the Property consistent with this opinion." (*Singh vs. Walt Disney* June 2020)

Appellate Court Calls for Revised Assessment

The appellate court instructed that the assessment of the Disney Yacht & Beach Club Resort utilize an income approach analysis that considers hypothetical rental rates for ancillary revenue sources such as restaurants, bars, meeting/convention space, retail stores, parking facilities, and spas at the subject property. Essentially, the decision implied that including this type of ancillary income (aside from rooms) in the projection of total hotel revenue includes a business enterprise component that would overstate the value of the real property.

For example, the court is suggesting that in establishing the market value of a lodging facility, the actual revenue generated from hotel restaurant(s) and lounge(s) selling food and beverages is not the appropriate income to consider. Rather, the revenue should be speculatively established by what the real property (land, buildings, fixtures, and all other improvements to land) would supposedly rent for, established by competing restaurants, bars, meeting/convention space, retail stores, parking facilities, and spa properties in the market.

In addition to representing a fabricated rental analysis, which more than likely is not the highest and best use of the subject hotel property, under almost all circumstances, this rental rate consideration results in a manufactured relative lower revenue and net operating income, and a resultant market value conclusion that is artificially low.

Appraiser Requests Second Hearing

On July 2, 2020, the Property Appraiser formally requested another hearing with the Florida Fifth District Court of Appeal to reconsider the June 19 conclusion that "… the Rushmore method violates Florida law ... ." The appraiser indicated that if the appellate court would not reconsider, the matter would be brought to the Supreme Court of Florida.

On August 7, 2020, the Florida Fifth District Court of Appeal issued a revised opinion of the case, which concluded that similar to the trial court, the appraiser had incorrectly applied the Rushmore Approach (*Singh vs. Walt Disney* August 2020). However, the revised opinion did not declare that the Rushmore Approach itself violates Florida law.

The June 19, 2020, decision was perceived by many advocates as a tremendous victory for owners of Florida hotels and, ultimately, titleholders of lodging properties across America. Although this was not the first time that a court of law had ruled against the Rushmore Approach, in the context of real property tax, for decades the Rushmore Approach has been embraced by tribunals throughout the nation.

EHP Glendale, LLC, et al. vs. County of Los Angeles

In *EHP Glendale, LLC, et al. vs. County of Los Angele*, the county appealed a trial court summary judgment order finding that the valuation methodology used by the assessor, and accepted by the Los Angeles County Assessment Appeals Board, to value a hotel property was contrary to California law because it failed to exclude the hotel's intangible assets from the real property tax assessment. In February 2011, the Court of Appeal reversed on grounds that summary judgment was inappropriate when less than the entire Board administrative record was before the trial court when it entered its summary judgment order.

However, the Court of Appeal nevertheless addressed the issue upon which the trial court decision was based, that is, whether the Assessor's hotel income approach valuation was legally flawed. The Court of Appeal disagreed with the trial court's finding that the appropriateness of the assessor's value methodology presented an issue of law. According to the Court of Appeal, the assessor's income approach method was valid and presented only a question of fact as to its application. Invoking the presumption of correctness, the court found there was substantial evidence to support the Board's decision and remanded the case to the trial court for trial (*EHP Glendale vs. County of Los Angles* 2011).

Second Decision on *EHP vs. County of Los Angeles*

On September 18, 2013, the Second District Court of Appeal issued a second decision. On remand of the first EHP decision, a new trial court judge applied both the de novo and substantial evidence standards in ruling the assessor's and Board's income approach methodology was valid as a matter of law, and that substantial evidence supported the Board's decision. The hotel owner once again appealed, claiming that the value method applied was flawed as a matter of law. The second EHP court affirmed, finding its prior decision in EHP constituted the law of the case, which it was bound by law to follow unless the law was altered by an intervening decision by a higher tribunal *(EHP Glendale vs. City of Los Angeles* 2013). On December 18, 2013, the California Supreme Court denied the hotel owner's petition for review; however, in doing so it also ordered that the second EHP decision not be published or cited as authority.

SHC Half Moon Bay, LLC v. County of San Mateo

In May 2014, the Court of Appeal of the State of California, First Appellate District, Division Five ruled in *SHC Half Moon Bay, LLC v. County of San Mateo*, relative to SHC's (owner of The Ritz-Carlton, Half Moon Bay) claiming the assessment methodology was invalid because the assessment included nontaxable intangible assets. While the court ruled that the deduction of a management and franchise fee from the hotel's projected revenue stream was proper to remove the value of the hotel's intangible assets from the real property assessment, the ruling states that it did not entirely identify and exclude all intangible assets *(SHC Half Moon Bay vs. County of San Mateo* 2014).

Chesapeake Hotel LP vs. Saddle Brook Township

Chesapeake Hotel LP vs. Saddle Brook Township (Tax Court of New Jersey Docket No. 001690-99) was a seminal case decided on October 26, 2005. Highlights of Judge Peter D. Pizzuto's written decision include the following:

Court Accepts Rushmore Approach

"In Glenpointe (1989 New Jersey tax court case Glenpointe Associates vs. Township of Teaneck), the court accepted the conclusions of an expert appraisal witness, Stephen Rushmore, concerning the particular adjustments that are necessary to extract nonrealty income from total income so as to compute the income to be capitalized into real estate value." (*Chesapeake Hotel LP vs. Saddle Brook Township* 2005)

Income Attributable to FF&E Excluded from Realty Income

"Rushmore considered that all payments to the entity that manages and operates the hotel constitute business income generated by the exercise of management and entrepreneurship. Accordingly, he excluded these payments in the computation of realty income subject to capitalization. In addition, Rushmore considered that a portion of the overall income was realized by the employment of furniture, fixtures, and equipment (often referred to as FF&E). Since these items are (generally speaking) personal property rather than real estate, the income attributable to them, under Rushmore's method, is also excluded from realty income. Separate adjustments are made to provide for the periodic replacement of the personal property (the return of FF&E) and also for a yield on the investment in personal property (the return on FF&E). This method has been employed by experts in other hotel valuation cases and followed in reported decisions in New Jersey and other jurisdictions." (*Chesapeake Hotel LP vs. Saddle Brook Township* 2005)

Speculative Methodologies Abound

During the past 40 years, much has been written on what is commonly referred to today as "total assets of the business" or "business enterprise approach," and how the concept relates to lodging facilities. Unfortunately, most of what has been esoterically posited has been baseless and unsubstantiated by "the market" and has been put forth, for the most part, by generalist professionals who have no hotel educational background; little, if any, hands-on hotel operational experience; and little, if any, hotel investment expertise.

Essentially, these speculative methodologies are merely hypothetical academic constructs without any market foundation that have been developed for advocates for the sole purpose of reducing hotel property tax burdens. Analysis of the actions of hotel investors, however, indicates that the purchase of a hotel property reflects the acquisition of real and personal property only. Hotel investors account for income attributable to the business through the expense deduction of management and franchise fees. An investor purchasing a hotel "unencumbered" by a management agreement will not pay for a seller-assembled work force, business name, patents, copyrights, working capital and cash, operating procedures, and manuals. A passive investment in a first-class hotel "encumbered" by a long-term hotel management agreement is riskier, but no different than a passive investment in a class A office building occupied by a long-term creditworthy tenant. Either passive investment yields a risk adjusted return on property and not a business.

Conclusion

There can be only one market value, and the method employed to determine such must be the same under any circumstance, including property tax appeals. In other words, the assets and the rights being valued do not change simply because the valuation approach to an appraisal varies. Knowledgeable hotel investment market participants including buyers, sellers, lenders, and intermediaries do not acknowledge the existence of, nor ascribe a separate value to, intangible asset(s). Other than a deduction for management and franchise-related fees, this element is not reflected in their underwriting and investment decisions.

It is only property tax advocates that utilize "total assets of the business" or "business enterprise approach" and for the sole purpose of attempting to achieve reduced hotel property assessment valuations. If "total assets of the business" or "business enterprise approach" were utilized for mortgage debt purposes, hotel real property market values could be highly deflated because an inordinate amount would be allocated to unfinanceable intangible assets, and result in greatly diminished debt proceeds and existing loans deemed underwater.

The issue of the appropriate treatment of hotel intangibles has engendered much confusion and discussion among appraisers, assessors, attorneys, judges, lenders, and regulators. The matter has been over-complicated for nothing, and way too much time has been spent debating this issue. The fact is that the Rushmore Approach has endured because it reflects the thinking and actions of hotel investment market participants. Until the market alters its underwriting/pricing of hotel assets, there is no justification for accepting unfounded "violation" and/or "illegal" judicial property tax valuation rulings promulgated by courts of law that know little, if anything, about real estate and/or hotels.

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