The "Hidden Dimension": Valuation, Taxation and Zoning of Entertainment Properties in Germany

FABIAN THIEL, Germany

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SUMMARY

Due to a change in national legislation in 2002 (“Law on legalizing of professional sex-workers”), professional nightclub labor is moving to the real estate marketplaces in Germany, along with an intense development of these specialized entertainment assets. By defining several streets as “exclusion areas” through planning mechanisms (zoning) since the 1960s for street and in-house prostitution, the zoning, clustering and agglomeration of entertainment properties caused an increase of land values. Derived from this case-study, the purpose of my paper is to highlight the following methodical questions and topics: Why is the cooperation between landowners of these estates with the planning and taxation/valuation authorities mostly rare? Even by using the profit method to appraise the market value, the attributes of entertainment assets are hard to determine since likely turnover data, maintenance costs, expenditures (cleaning, heating, security patrols, bribe money etc.) and taxation are hidden dimensions; income streams are vague.

Property values, especially land prices, have risen significantly since the last two years in Frankfurt. But can a “market value” for entertainment and/or leisure estates such as betting agencies, brothels, gambling halls and massage salons precisely be appraised? Obviously, the rent-seeking behavior of landowners in the area is evolving. As a consequence of the amended German Federal Building Code in 2013, planning authorities seek to regulate – and banish – places of entertainment. Taxation authorities are interested in the income of these landowners, the staff, and middlemen. Massive public intervention, enforced by strict zoning mechanisms, land valuation mapping (GIS), and property taxation tools will influence the market values of the affected buildings in all metropolitan cities in Germany. Which lessons can be learned from that for future urban development processes, urban renewal, trading-down and gentrification?
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1. INTRODUCTION

This paper aims to determine recent legal regulations for entertainment properties in Germany in general and in Frankfurt on the Main in general. Since the 1950s, the city government of Frankfurt seeks to regulate exclusionary areas for leisure purposes and prostitution services by zoning activities, e.g., by by-laws and decrees such as the Decree on Security and Order, Youth Protection and Public Decency from 28th December 1960 (“Sperrgebietsverordnung”). What was meant as an instrument to steer and regulate certain (and unwanted) street and in-house prostitution activities from the 1960s onwards, turned out to be as a legal instrument to protect the owners of entertainment and prostitution properties. Until today, it lead to an “non-aggression” contract between the public administration, the Police, and the landowners around the central railway station in core Frankfurt (Benkel 2010). Moreover, the these legal dimensions of the reality must be investigated since – as it is valid for other properties – legal issues and concerns as well as physical attributes, market conditions set real estate apart from other types of assets; in the case of entertainment properties, legal vehicles such as the Federal Building Code, the Law on Prostitution (2002) and by laws on building regulations are used to transfer and control the physical attributes of the involved properties (Fanning 2014).

Additionally, a normative pluralism of planning law occurs, with the underlying problem: the tolerance of conflicting uses especially in business zones with residential, retail, cultural, business and entertainment uses.

In the context of entertainment properties such as discotheques, night clubs, bars and gambling halls, the newly amended Federal Building Code (Section 9) intends to control and restrict entertainment properties. It is argued by the Federal legislator that these estates may affect the market values of the neighboring properties as well as a “trading-down” process of the area leading to an insecure, “dirty”, noisy, unfriendly environment with mono-functional uses. Hence, trading-down comes out as a valuation and zoning problem; the question of control is unsolved yet, e.g., restriction to maximum of two gambling halls in the area x? Who defines the size of area x?

A reverse problem in Frankfurt is gentrification. Similar to other metropolitan neighborhoods in Germany, gentrification and “trading-up” – the process of renewal and rebuilding that accompanies the influx of “new investors”, big money or affluent people into deteriorating areas, often in line with the displacement of poorer people – has indeed seen a resurgence in nearly all districts of Frankfurt. Frankfurt has value potential – territorial value. As far as investment is concerned, the times have changed palpably. The city is regarded as a good location for real estate investors from Germany and abroad. In top-rate locations such as
Westend, Nordend and partly the area around the railway station, real estate is often sold for four times its original market value.

Figures 1 and 2: The problem of agglomeration of entertainment properties, gambling halls and „betting-cafés“ within the vivid, lively and contested area around the central railway station of Frankfurt

The result of gentrification has also been in Frankfurt the renovation of older homes, and the conversion of multi-unit rental properties into condominiums, high-end fashion retail stores and restaurants, especially in the core business areas and surrounding the financial district (see figure 3).

2. REGULATIONS FOR ENTERTAINMENT PROPERTIES

The German property and planning system in general is supposed to base on property market transparency and flexibility (Dieterich/Dransfeld/Voß 1993; Kleiber 2014; Usinger/Schneider 2009). In theory, precautions in favour of competition over use rights and against speculation and the manipulation of prices are often structurally enshrined within the land use planning guidelines and mechanisms. However, reality is quite different: the decision about land use changes has to be made by the municipality during the planning process, due to the difficulties in assessing external effects and because of other problems. The planning process should be neutral – meaning, the competing claims of the landowners is balanced in order to optimize the “highest and best use” of the sites in private and public interest.
Figure 3: Map of the area around Frankfurt’s central railway station (with existing usages in the upper levels; as of 2012)

Germany has a legal basis for a comprehensive hierarchic spatial planning and zoning system, consisting of the

- Federal Spatial/Territorial Planning Act;
- Federal Building Code;
- Federal Land Utilization Ordinance;
- Urban Renewal and Development Act and
- In case of entertainment properties: local laws, decrees, and contracts, e.g. for exclusionary and restricted areas such as the limited zone of certain streets “reserved” for entertainment in general and particularly prostitution services in the area around the Frankfurt railway station (see figure 3 above).

These regulations give overall legal framework conditions affecting urban development with detailed prescriptions for urban planning law, building permission applications and zoning.
With emphasize on entertainment properties, the following legal framework is to be taken into consideration:

- German Constitution (especially article 12, freedom to choose an occupation)
- Federal Building Code (amended in 2013)
- Land Use Ordinance
- Tax laws (e.g., amusement tax)
- Local fees
- Industrial Code
- Programs on urban restructuring and upgrading (see figure 4)
- Decrees for exclusionary zones, e.g., in Frankfurt, Hamburg, Munich
Figure 5: An ideal asset of an entertainment property – a discotheque

We have to be aware of the unclear legal definition of an “entertainment property” in Germany. According to the German Federal Administrative Court, the following differentiation of “What is an entertainment property?” exists:

- discotheque – yes
- nightclub – yes
- swinger club – yes
- betting agency – no (because it is subsumed under “retail properties”)
- brothels and massage salons – no (because it is subsumed under “business properties”)
- … and “condominiums/apartments/studios” with the purpose of delivering leisure and/or sexual services?

3. VALUATION OF ENTERTAINMENT PROPERTIES

Land valuation applications suitable for entertainment/leisure properties consist of two general families of German land valuer's activities: Appraising (see table 2) and Assessment (see table 3). Both techniques are based on the same foundations and are thus subject to the same methods of valuation. Appraising means detailed expertise, while assessment is a mass-application through coded structures. Mass appraising aims at private expertise while assessment is ordered from governmental authority in view of territorial inventory and ad valorem taxation (e.g. for amusement tax and property tax of the entertainment asset) on these immovable properties. Assessment is covered by law (land valuation ordinance) and submitted to a specific national policy; such a policy is limited to assessment practices. Taxation and valuation are based on a fairly sophisticated assessment and appraisal for the rate-setting process according to the following tables 1 and 2.
### Definition
A formal opinion of value prepared as a result of a retainer, intended for reliance by identified parties, and for which the appraiser assumes responsibility.

### Characteristics
Appraisal involves selective research into appropriate market areas, the use of appropriate analytical techniques, and the application of knowledge, experience, and professional judgement to develop an appropriate solution to a specific appraisal problem. The appraiser provides the client with an opinion of value on an immovable property that reflects market evidence.

### Examples
An opinion of market value for an immovable entertainment property, leasehold estate, preservation easement, or other estate (to assist in mortgage lending decisions, to assist in purchase or sale decisions); an opinion of investment value or some other properly defined value of an identified interest in real estate at a specific date for specific objectives (using the profit method for entertainment assets such as nightclubs, table dance bars, brothels; see e.g., Isaac/O’Leary 2012).

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Appraisal and assessment require market monitoring and data storage in a timely and updated manner for the purchase of prices, for rent prices and statistics regarding to construction materials. The land-information-system (LIS), consisting of cadastral maps and land registry, serves both as data storage and land valuation mapping to combine property and site related data (e.g., size, location, condition). Actualization of data should happen to secure the updating of data bases and to ensure the integrity of the tax base on immovable properties to distinguish between data assessed values (Kleiber 2014). It is essential to actualize the existing Data Bases (DB), especially for entertainment properties with a comparable short life expectancy. The newly (2010) implemented ImmoWertV [“Immobilienwertermittlungsverordnung”: German Ordinance on the Valuation of Real Estate] contains internationally recognized and nationally owner-binding rules for determining the market value using three standardized valuation methods: comparison method, income (investment) method, and the depreciated reconstruction (cost) method. The ImmoWertV describes the necessary data, and refers to the data that were recorded by the committees of valuation experts. Publicly-appointed valuation experts refer to these methods and the data provided by the committees of valuers in order to guarantee a level of comparability and transparency on the land market (European Valuation Standards).

Figures 6 and 7: Brothel named “KOMM” in Frankfurt on the Main as subject to valuation: Cannibalization from competing leisure properties

The appraiser of entertainment properties and other “exotics” of immovable assets faces numerous problems. There are only official data on the average number of customers in Germany: 1.2 Million (male) customers in Germany p.a.; turnover: 14 billion € (2013); from that approx. 50 % for bribe money (so called danegeld), rent, clothing, and security (maintenance). A lack of market guidelines for properties such as brothels, massage clubs, swinger clubs and night-bars is obvious.
Further critical points and research fields of market analysis are:
- Estimation of “market activity”?
- Definition of “market value” for entertainment properties?
- Definition of ownership arrangements, leases, bribe money (so called danegeld), and (hidden) “operating costs”?
- Generally: Lack of convenient data source for entertainment properties.

For the property “KOMM”, core data can be given such as: Total rooms available per annum: 172 lettable rooms; 45% room occupancy rate; Average achieved room rate: 120 € per night, excluding cost for service, clothes, food; Running property expenses: 60,000 € for heating, 12,000 € for marketing and security. However: Unknown data on revenue, food, beverages; unknown data YP in perpetuity; unknown total turnover data.

4. CONCLUSION: SUSTAINABLE CITY AND ENTERTAINMENT PROPERTIES

Nowadays, urban planning and participatory land policies have to be conceived of in a complex and contemporary fashion – not just in Frankfurt. However, what has been missing in Frankfurt and other municipalities in Germany is a platform for implementation proposals for dealing with entertainment properties an how to integrate them in urban restructuring/urban renewal processes rather than “just” to ban and regulate them; the cooperation with the landowners is anything else than optimal. Trading-down processes emerge with the phenomenon of gentrification: Because the topics relevant for a social city have also changed, with a move away from raising the status of the “problem areas” and towards dealing with the problem of the displacement of the socially disadvantaged from the city centre. The guiding questions for the reorientation could be: Who owns the land value profits from value-enhancing neighbourhood development by means of interim use and renovation? Who pays for trading-down-based losses? Why are land value increases due to neighbourhood development not being skimmed off? Are the criteria of a social city changing? Who owns the urban return? What community added value and what social control is provided by tightly networked social, commercial, retail and entertainment assets and properties? How will the financing of future urban renewal be structured: by means of cooperation, legal agreements and/or by force? Who will finance urban renewal in future (if not partly the landowners)?
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BIOGRAPHICAL NOTES

Prof. Dr. Fabian Thiel, born on October 3, 1968, studied geography at the University of Hamburg and law at the University of Regensburg. From 2001 to 2008, he worked as academic staff for the Hochschul-Informations-System (HIS, Hannover), for the Environmental Research Centre (UFZ, Leipzig-Halle) and as a freelance land policy advisor. From September 2008 to August 2011, he served as a faculty advisor and lecturer for the Faculty of Land Management and Land Administration at the Royal University of Agriculture (Phnom Penh, Cambodia). Since September 2011, he is professor of real estate and land valuation at the University of Applied Sciences in Frankfurt/Main. Fabian Thiel focuses on teaching and researching fields like land law, planning law, constitutional law, land policy and land valuation. He is the author of several monographs, articles, research reports and papers about international land management and land policy.

CONTACTS

Prof. Dr. Fabian Thiel
Frankfurt University of Applied Sciences
Nibelungenplatz 1
60318 Frankfurt am Main
GERMANY
Tel. + 49 69 1533 2337
Fax + 49 69 1533 2058
Email: bodenrecht@fabian-thiel.de
Web site: www.fabian-thiel.de