REPRESENTATIVE FOR PETITIONER:
Brad Hasler, BINGHAM McHALE, LLP

REPRESENTATIVE FOR RESPONDENT:
Marilyn Meighen, MEIGHEN & ASSOCIATES, PC

BEFORE THE
INDIANA BOARD OF TAX REVIEW

Pines Apartments,	)	Petition No.: 47-011-02-1-4-00012
	)	Parcel: 1100515700
Petitioner,	)	
	)	
v.	)	
	)	County: Lawrence
Shawswick Township Assessor,	)	Township: Shawswick
	)	
Respondent.	)	Assessment Year: 2002

Appeal from the Final Determination of
Lawrence County Property Tax Assessment Board of Appeals

July 26, 2007

FINAL DETERMINATION

The Indiana Board of Tax Review ("Board") having reviewed the facts and evidence, and having considered the issues, now finds and concludes the following:

FINDINGS OF FACT AND CONCLUSIONS OF LAW

ISSUES AND SHORT ANSWERS

Issue I

1. The Respondent moved to dismiss this appeal upon the Petitioner concluding its case-in-chief. The administrative law judge took the Respondent's motion under advisement and the Respondent then presented evidence as part of its own case-in-chief. While not specifically addressed by the parties, the Board must consider whether, by presenting its own evidence, the Respondent waived its request for the Board to consider the appeal based solely on evidence that the Petitioner introduced in its case-in-chief.

2. By presenting its own evidence, the Respondent waived its request for the Board to consider the case solely on the evidence introduced in the Petitioner's case-in-chief. To hold otherwise would promote form over substance. The Board therefore denies the Respondent's motion to dismiss and considers the record as a whole in determining whether the Petitioner has met its burden of proof.

Issue II

3. The subject property is part of a federal low-income-housing program under which the Petitioner received a subsidized mortgage loan in exchange for agreeing to various restrictions on the property's use. The Petitioner submitted an appraisal that relied solely on a discounted-cash-flow analysis in which the appraiser considered the property's restrictions but not the federal interest subsidy. The Respondent, by contrast, submitted an appraisal containing a value estimate that is substantially higher than the Petitioner's request, but still significantly below the property's current assessment. The Board therefore must consider whether based on the record as a whole, the Petitioner proved its entitlement to a reduction in the subject property's assessment, and if so, what the reduced assessment should be.

4. A preponderance of the evidence supports reducing the subject property's assessment, although not by the amount that the Petitioner requests. The Petitioner's appraisal lacks probative value. The appraiser, Phillip D. Johns, did not support key assumptions underlying his discounted-cash-flow analysis. Mr. Johns also ignored income from the subject property used to service the Petitioner's mortgage loan. And he based his analysis on the mistaken notion that the federal interest subsidy was an intangible property right that could not be considered in determining the true tax value of real property. Nonetheless, the Respondent's own appraisers estimated the subject property's market value to be substantially below its assessment. And while their valuation opinion also suffers from significant flaws, those flaws led the appraisers to overstate — not understate — the property's value. Thus, a preponderance of the evidence demonstrates that the subject property's true tax value was no more than $585,000 — the amount estimated by the Respondent's appraisers.

PROCEDURAL HISTORY

5. On December 10, 2004, the Lawrence County Property Tax Assessment Board of Appeals ("PTABOA") issued its determination on the Petitioner's assessment appeal. On January 5, 2005, the Petitioner filed a Form 131 Petition to the Indiana Board of Tax Review for Review of Assessment. The Board has jurisdiction to hear the Petitioner's appeal under Ind. Code §§ 6-1.1-15 and 6-1.5-4-1.

6. The above-captioned appeal presents issues similar to those presented in four other appeal petitions. The parties therefore agreed to a consolidated hearing on all five appeals.[1] On January 31, 2007, Jennifer Bippus, the Board's duly designated administrative law judge ("ALJ"), held that consolidated hearing in Bedford, Indiana. Because the parties presented some evidence specific to the individual apartment complexes, the Board will issue separate final determinations.

[1] The hearing involved the following appeal petitions: *Pines Apartments v. Shawswick Twp. Assessor*, Pet. No. 47-011-02-1-4-00012; *Bedford Limited d/b/a Clover Park I & II v. Shawswick Twp. Assessor*, Pet. Nos. 47-011-02-1-4-00010 and 47-011-02-1-4-00011; and *Mitchell Limited d/b/a Elm Park I and Mitchell Limited II d/b/a Elm Park II v. Marion Twp. Assessor*, Pet. Nos. 47-012-02-1-5-00033 and 47-012-02-1-5-00034.

7. The following persons were sworn in as witnesses:

For the Petitioner:

Edwin K. DeWald, DeWald Property Tax Services
Randall Warner, DeWald Property Tax Services
Phillip D. Johns, The Value Company

For the Respondent:

Kirk Reller, Technical Advisor the Lawrence County Assessor,
Shawswick Township Assessor, and the Marion Township Assessor
Gilbert S. Mordoh, Gilbert S. Mordoh & Company, Inc.

8. The following persons observed the hearing:

April Stapp Collins, Lawrence County Assessor
Tammie Jean, Shawswick Township Assessor
Nancy Miller, Marion Township Assessor

9. The Petitioner submitted the following exhibits:

Petitioner Ex. P1: Appraisal Report of Pines Apartments
Petitioner Ex. P2: Appraisal Report of Elm Park I
Petitioner Ex. P3: Appraisal Report of Elm Park II
Petitioner Ex. P4: Appraisal Report of Clover Park I
Petitioner Ex. P5: Appraisal Report of Clover Park II
Petitioner Ex. P6: Sales Disclosure for Country Place II Apartments
Petitioner Ex. P7: Appraisal Review of the Appraisal Completed for Pines of Bedford
Petitioner Ex. P8: Copy of USPAP effective July 1, 2006
Petitioner Ex. P9: Appraisal Review of the Appraisal completed for Clover Park I & II
Petitioner Ex. P10: Appraisal Review of the Appraisal completed for Elm Park I & II
Petitioner Ex. P11A-E: Petitioner Response to Respondent's Motion to Dismiss

10. The Respondent submitted the following exhibits:

Respondent Ex. R1: Limited Appraisal of Pines of Bedford
Respondent Ex. R2: Limited Appraisal of Clover Park I & Clover Park II
Respondent Ex. R3: Limited Appraisal of Elm Park I & Elm Park II
Respondent Ex. R4A-C: Post Hearing Brief for the Township Assessor

11. The following additional items are officially recognized as part of the record of proceedings:

    Board Exhibit A – Form 131 petition
    Board Exhibit B – Notice of Hearing
    Board Exhibit C – Hearing Sign-In Sheet

12. The subject property, known as the Pines, is an apartment complex located at 2010 Stevens Avenue, Bedford.

13. The ALJ did not inspect the subject property.

14. For 2002, the PTABOA determined the assessed value of the property to be:
    Land: $62,800 Improvements: $755,300 Total: $818,100.

15. At the hearing, the Petitioner requested the following assessment:
    Land: $62,800 Improvements: $0 Total: $62,800.[2]

MOTION TO DISMISS

16. Upon the Petitioner concluding its case-in-chief, the Respondent moved to dismiss the appeal, contending that the Petitioner failed to make a prima facie case. The Petitioner requested leave to file a responsive brief. The ALJ took the Respondent's motion under advisement and set a briefing schedule. The Respondent then presented its case-in-chief, in which it submitted, among other things, a limited summary appraisal report prepared by Paul W. Weber and Gilbert S. Mordoh. Mr. Mordoh also testified on the Respondent's behalf.

17. The Respondent did not cite to, nor does the Board find, any explicit authority in its procedural rules for the Respondent's motion to dismiss. The Indiana Rules of Trial

[2] On its Form 131 petition, the Petitioner requested the following assessment:

Land: $62,800 Improvements: $460,800 Total: $523,600.

Procedure, however, contemplate such motions. Thus, under T.R. 41(B), an opposing party may move to involuntarily dismiss a claim when the party bearing the burden of proof completes its case-in-chief. If, however, the movant then presents its own evidence, it waives any claim that the court erred in denying its motion. *Hoosier Ins. Co. v. Ogle*, 150 Ind. App 590, 592, 276 N.E.2d 876, 878 (1971). The case then is decided on the record as a whole. That result promotes substance over form and serves the policy of deciding cases on their merits. *Pinkston v. State*, 163 Ind. App. 633, 635, 325 N.E.2d 497, 498-99 (1975).

18. The Board will not promote form over substance. And it certainly will not foster an administrative forum that is more formal and technical than what the Indiana Rules of Trial Procedure require for courts. The Board therefore denies the Respondent's motion to dismiss. That is not to say that the Petitioner is relieved of its burden of proof; rather, the Board will consider the record as a whole — not just the evidence presented in the Petitioner's case-in-chief — in determining whether the Petitioner met its burden.

ADMINISTRATIVE REVIEW AND THE PETITIONER'S BURDEN

19. A petitioner seeking review of an assessing official's determination has the burden to establish a prima facie case proving that the current assessment is incorrect, and specifically what the correct assessment would be. *See Meridian Towers East & West v. Washington Twp. Assessor*, 805 N.E.2d 475, 478 (Ind. Tax Ct. 2003); *see also, Clark v. State Bd. of Tax Comm'rs,* 694 N.E.2d 1230 (Ind. Tax Ct. 1998).

20. In making its case, the taxpayer must explain how each piece of evidence is relevant to its requested assessment. *See Indianapolis Racquet Club, Inc. v. Washington Twp. Assessor*, 802 N.E.2d 1018, 1022 (Ind. Tax Ct. 2004) ("[I]t is the taxpayer's duty to walk the Indiana Board . . . through every element of the analysis").

21. Once the petitioner establishes a prima facie case, the burden shifts to the assessing official to impeach or rebut the petitioner's evidence. *See American United Life Ins. Co.*

v. Maley, 803 N.E.2d 276, 281-82 (Ind. Tax Ct. 2004)*; see also Meridian Towers*, 805 N.E.2d at 479.

ANALYSIS

<u>Findings of Fact</u>

22. The subject property contains several one-story apartment buildings with a total of 31 units, all built in 1982. *Ex. P1 at 4.* It is part of a program run by the United States Department of Agriculture's Rural Development branch ("Rural Development") under Title V, Section 515 of the 1949 Housing Act. Under that program, the Petitioner financed 95% of the subject property's original cost through mortgage loans from Rural Development. *Johns testimony; Ex. P1 at 9-10.* Rural Development provides a credit to reduce the Petitioner's interest payments to 1% of the principal loan amounts, and the loans are amortized over 50 years. *Id.* The Petitioner did not disclose its original loan amount, but the unpaid balance was approximately $600,000 as of March 1, 2002. *Ex. P1 at 38.*

23. In exchange for those favorable loan terms, the Petitioner agreed to subject its property to several restrictions. The Petitioner must lease its apartments to qualified low-income tenants for the life of the loan. *Ex. P1 at 10*. The Petitioner must also complete annual budgets for Rural Development's approval. Rural Development uses those budgets to set rent levels. *Id. at 24*. Rural Development applies a formula premised on the notion that, after allowing all approved expenses, including debt service, the property's net income should be at or near zero. *Id*. If, however, net income exceeds 20% of the property's operating and maintenance expenses, Rural Development may revise the following year's budget by decreasing rents, or, as is more likely, the Petitioner may transfer the excess into a reserve account that Rural Development requires the Petitioner to maintain. *Id.* The Petitioner must fund its reserve account with annual payments equal to 1% of the original loan. *Id at 31*. The account is fully funded when its balance reaches 10% of the original loan. *Id*.

24. If the Petitioner is on track to fully fund its reserve account, it may keep a limited amount of net income, known under the Section-515 program as "return to owner" ("RTO"). The annual RTO cannot exceed 8% of the Petitioner's initial equity investment. In the subject property's case, the RTO is capped at $3,834 per year. *Id. at 25*. The Petitioner may deposit any additional revenue in an excess-cash account. The excess-cash account's ending balance cannot exceed 20% of the property's operating and maintenance costs. *Id.* at 26. As of March 1, 2002, the excess-cash account's maximum-allowable ending balance was $20,000, and its actual balance was approximately $16,300. *Id*.

25. While Section-515 loans are amortized over 50 years, a property owner can pre-pay its loan balance after 20 years. At that time, the owner can convert its property into conventional apartments, although it must continue to rent to existing tenants at non-market rates until they vacate their apartments. *Ex. P1 at 10*.

26. The Petitioner submitted an appraisal prepared by Mr. Phillip Johns, a certified general appraiser with 19 years experience. *Johns testimony; Ex. P1 at 2*. Mr. Johns worked for Rural Development for over two years. *Johns testimony; Ex. 1 at 41*. During that time, Mr. Johns appraised approximately 75 Section-515 properties and reviewed approximately 150 more Section-515-property appraisals. *Johns testimony*. Mr. Johns certified that he complied with the Uniform Standards of Professional Appraisal Practice ("USPAP") in appraising the subject property. *Johns testimony; Ex. P1 at 14*.

27. Although appraisers typically consider the cost, sales-comparison, and income-capitalization approaches in valuing conventional apartment complexes, Mr. Johns relied solely on the income-capitalization approach to value the subject property. *Johns testimony; Ex. P1 at 11, 23-40*. According to Mr. Johns, the sales-comparison approach does not apply when valuing multi-family properties financed by Rural Development. *Id*. In fact, Rural Development discourages appraisers from using the sales-comparison approach to value such properties due to the lack of sales and the difficulty in meaningfully adjusting comparable properties' sale prices to account for financing terms.

Id. Mr. Johns likewise did not consider the cost approach because, in his view, the subject property suffered from "enormous" depreciation. *Johns testimony; Ex. P1 at 11.* Also, Mr. Johns did not include the value of Rural Development's interest subsidy because he viewed that subsidy as an intangible asset. *Id.*

28. According to Mr. Johns, the income-capitalization approach converts a property's anticipated benefits — the cash flows it generates and its reversion — into its market value. *Johns testimony; Ex. P1 at 23*. And he identified two methods for making that conversion. Under the first method, an appraiser uses a market-derived rate to capitalize a single-year's income. *Id*. Under the second method, an appraiser applies a discount rate to the property's annual cash flows and reversion over a specified holding period. *Id*. Mr. Johns referred to the second method as a discounted cash flow ("DCF") analysis. *Id*.

29. Mr. Johns used a DCF analysis to value the subject property rather than simply capitalizing one year of the subject property's net operating income. Mr. Johns based his choice on the theory that owners of older Section-515 properties typically wish to convert those properties to conventional housing when financially feasible. *Johns testimony, see also Ex. P1 at 24, 38.* According to Mr. Johns, a DCF analysis is preferable to direct capitalization where conversion is not presently feasible. *Id*.

30. According to Mr. Johns, a sale will be feasible when the property's reversion — which he defined as the property's market value as a conventional apartment complex — plus its RTO and account balances, exceeds the Petitioner's outstanding mortgage-loan balance. *Johns testimony; Ex. P1 at 38.*

31. To determine the subject property's March 1, 2002, reversion, Mr. Johns capitalized its stabilized net operating income as if it was a conventional apartment complex. *Johns testimony; Ex. P1 at 26.* He determined the property's projected rental income and an appropriate vacancy- and collection-loss rate based upon a 1999 market study and 2000 census data. *Johns testimony; Ex. P1 at 27-32.* And he estimated the property's operating expenses for 2002 based upon its actual expenses from 2000 and 2001. *Id.* He

did not include debt-service as an operating expense. *Ex. P1 at 30.* Mr. Johns ultimately estimated the subject property's net operating income at $10,638. *Johns testimony; Ex P1 at 32.*

32. Mr. Johns then calculated what he believed to be an appropriate capitalization rate to apply to his estimated net operating income. Mr. Johns noted that an overall capitalization rate ("OAR") is most appropriately determined from the marketplace. *Johns testimony; Ex. P1 at 33.* Unfortunately, there were insufficient sales of Section-515 projects that were subsequently converted to conventional housing from which to derive an OAR. *Id.* Mr. Johns therefore looked to Valuation Insights and Perspectives, a publication of the Appraisal Institute, and estimated that an appropriate OAR was between 11% and 12%. *Id.*

33. To test his estimate's reasonableness, Mr. Johns also calculated a capitalization rate using the mortgage-equity-band-of-investment method. *Johns testimony; Ex. P1 at 33-37.* Under that methodology, an appraiser analyzes the mortgage and equity components of financing to arrive at an OAR. *See Id.* Mr. Johns examined historical rates for multi-family-housing-project loans through the Department of Housing and Urban Development, and determined that such loans typically had a 70% loan-to-value ratio with a 6.81% interest rate amortized over 20 years. *Id.* To determine an appropriate equity-yield rate, Mr. Johns compared the risk of investing in Section-515 properties with the risk of an alternative investment — small domestic mutual funds. *Id.* Mr. Johns estimated an equity-yield rate of 14%, which reflects a risk factor somewhere between the two investments. *Id.* Thus, Mr. Johns determined an OAR of 8.9%, to which he added the subject property's tax rate to arrive at an adjusted OAR of 11.2%. *Id.*

34. Mr. Johns used the 11.2% OAR to capitalize the subject property's stabilized net-operating income and arrived at a 2002 reversion value of $92,600. *Johns testimony; Ex. P1 at 38.* That reversion value, even when combined with the reserve- and cash-account balances, was substantially less than the property's March 1, 2002, loan balance, which was approximately $600,000. *Id.* Thus, Mr. Johns determined that it would not have

been feasible for the Petitioner to sell the subject property in 2002. *Id.* According to Mr. Johns, it would only be feasible to sell the property when the sum of its reversion value, account balances and RTO exceeds the Petitioner's loan balance. *Id.* Assuming that the subject property's reversion value would increase by 1% annually, Mr. Johns determined that the first feasible sale date would be in the year 2026. *Id*. Mr. Johns therefore determined that a DCF analysis was appropriate.

35. In his DCF analysis, Mr. Johns discounted to two potential income sources — the Petitioner's RTO, and the property's terminal-year[3] reversionary income, which he defined as the terminal-year reversion value, plus the terminal-year cash- and reserve-account balances. *Johns testimony; Ex. P1 at 24-26, 38-39*. Because the Petitioner was not on track to fully fund its reserve account, Mr. Johns predicted that the Petitioner would not receive any RTO during the holding period. *Johns testimony; Ex. P1 at 38-39*. Thus, Mr. Johns did not impute any annual income stream to the property over the course of the holding period. Instead, Mr. Johns discounted a total of $149,400 of income, all in the final year of his 25-year holding period, which he based on the number of years between the assessment date and the first feasible sale date. *Id*. The $149,400 was the sum of the 2002 reversion appreciated at the rate of 1% per year, plus the March 1, 2002, account balances, which Mr. Johns estimated would not increase over the course of the holding period. Mr. Johns applied an annual-discount factor of 11.38%, which he obtained from Valuation Insights & Perspectives, to arrive at a true tax value of $10,000. *Id*.

36. Mr. Johns, however, conceded that his estimate was less than the subject land's $62,800 assessment. *Johns testimony; Ex. P1 at 40.* According to Mr. Johns, the subject buildings detract from the property's value as a whole. Under those circumstances, an appraiser typically would adjust the land's value downward. *Id.* But Mr. Johns recognized that the Respondent's software is incapable of showing a negative value for

[3] The Board refers to the last year of the holding period used by Mr. Johns as the "terminal year."

improvements. *Id.* Thus, in Mr. Johns's opinion, the value of the improvements should be reflected as $0, leaving the property's overall true tax value as $62,800. *Id.*

37. The Respondent presented a limited appraisal report prepared by Gilbert S. Mordoh, and Paul E. Weber of Gilbert S. Mordoh & Company, Inc. *Ex. R1*. Messrs. Mordoh and Weber ("Mordoh appraisers") are both certified general appraisers. *Id*. The Mordoh appraisers stated that they complied with USPAP in preparing their appraisal. *Id. at 1.*

38. The Mordoh appraisers estimated the subject property's market value at $585,000 as of January 1, 1999. *Mordoh testimony; Ex. R1 at 1.* In doing so, they looked at all three generally accepted approaches to value, although their final value estimate matched their conclusions under the income-capitalization approach. *Mordoh testimony; Ex. R1, passim.* The Mordoh appraisers estimated the subject property's value at $695,000 or $21,700 per unit, under the sales-comparison approach. *Mordoh testimony; Ex. R1 at 7-8.* Due to the lack of "specific comparables" in the Bedford market, however, the Mordoh appraisers did not rely significantly on their conclusions under that approach. *Id.* They similarly gave little weight to their cost-approach estimate. *See Ex. R1 at 11*.

39. Under the income-capitalization approach, the Mordoh appraisers used the actual January 1, 1999, rents from either the subject property or Cambridge Square[4] to estimate the subject property's potential gross income ("PGI"). *Mordoh testimony; Ex. R1 at 9.* They estimated the property's vacancy and collection losses at 5% of its PGI. *Id.* The appraisers ultimately estimated the subject property's net operating income at $63,602. *Id.*

40. The Mordoh appraisers used an OAR of 10.89% to capitalize the subject property's net operating income. *Ex. R1 at 10*. They determined their OAR using a band-of-investment analysis, assuming a 75% loan-to-value ratio, an 11.19% mortgage constant, which they

[4] Page 9 of the Mordoh appraisal indicates that the appraisers used actual rents from the "subject property." *Ex. R1 at 9*. Page 10, however, indicates that the appraisers used actual income and expenses from "Cambridge Square operations." *Id. at 10.* Cambridge Square is a multi-tenant property located near the subject property. *Id. at 2*

based on a loan at 9% interest amortized over 20 years, and a 10% equity yield *Mordoh testimony; Ex. R1 at 10.* The appraisers, however, did not explain the basis underlying their choice of financing terms and equity yield. *See id.*

41. Mr. Johns prepared a written review of the Mordoh appraisal, analyzing whether it complied with USPAP. *Ex. P7.* Mr. Johns concluded that the Mordoh appraisal failed to comply with USPAP in several respects. *Johns testimony; Ex. P7 at 7-14.* For example, the Mordoh appraisers failed to recognize that the subject property was part of the Section-515 program, which placed significant restrictions upon its use. *Id.* In Mr. Johns's view, that failure poisoned the Mordoh appraisers' analyses under the sales-comparison and income-capitalization approaches. *Id*. Indeed, by failing to consider the Section-515 restrictions, the Mordoh appraisers ignored Indiana's standard of true tax value, which is based on value-in-use. *Id*.

42. Mr. Johns also identified what he claimed were various factual errors in the Mordoh appraisal. For example, the Mordoh appraisers valued the subject property as having 32 units rather than the 31 units that it actually contained. *Id*. Similarly, the Mordoh appraisers misstated the mortgage constant for a loan at 9% interest amortized over 20 years as .1119. *Id at 12*. The correct mortgage constant for such a loan is .1080. *Id*. Mr. Johns further identified various reporting errors, such as the Mordoh appraisers' characterization of their appraisal as a "complete" and "limited" appraisal. Not only is that characterization contradictory, the latest edition of USPAP does not include the terms "limited" and "complete" when referring to types of appraisal reports. *Id*. at 13.

Discussion

43. The 2002 Real Property Assessment Manual ("Manual") defines the "true tax value" of real property as "the market value-in-use of a property for its current use, as reflected by the utility received by the owner or a similar user, from the property." 2002 REAL PROPERTY ASSESSMENT MANUAL at 2 (incorporated by reference at 50 Ind. Admin. Code 2.3-1-2). As set forth in the Manual, the appraisal profession traditionally has used three

methods to determine a property's market value: the cost, sales-comparison, and income approaches. *Id*. at 3, 13-15. In Indiana, assessing officials generally assess real property using a mass-appraisal version of the cost approach, as set forth in the Real Property Assessment Guidelines for 2002 – Version A ("Guidelines").

44. A property's market value-in-use, as determined by applying the Guidelines, is presumed to be accurate. *See* MANUAL at 5; *Kooshtard Property VI, LLC v. White River Twp. Assessor,* 836 N.E.2d 501, 505 (Ind. Tax Ct. 2005) *reh'g den. sub nom. P/A Builders & Developers, LLC*, 846 N.E.2d 899 (Ind. Tax Ct. 2006). But a taxpayer may offer evidence to rebut that presumption, provided such evidence is consistent with the Manual's definition of true tax value. MANUAL at 5. A professional appraisal prepared in conformance with the Manual's definition of true tax value USPAP generally will suffice. *Kooshtard Property VI*, 836 N.E.2d at 505, 506 n.1.

45. The Petitioner relies on Mr. Johns's appraisal. Mr. Johns is a certified appraiser with substantial experience in appraising Section-515 properties, although not necessarily for ad valorem tax-appeal purposes. Mr. Johns relied upon a DCF analysis — a variant of the income-capitalization approach to value. USPAP specifically recognizes DCF analysis as an accepted appraisal method, albeit one that is "vulnerable to misuse." *See Ex. P8 at 20, 82*.

46. The Respondent, however, contends that Mr. Johns's appraisal is not probative of the subject property's market value-in-use, and that the Petitioner therefore failed to make a prima facie case. First, the Respondent contends that Mr. Johns did not appraise the subject property based on its current use, but rather upon its projected use 25 years in the future. Second, the Respondent contends that Mr. Johns disregarded Indiana law when he failed to consider the interest subsidy from Rural Development. Finally, the Respondent argues that Mr. Johns's appraisal is rife with unsupported assumptions that greatly affect his value estimate.

47. The Board agrees that Mr. Johns's appraisal suffers from significant flaws that detract from its probative value. Several of those flaws are closely tied to Mr. Johns using a DCF analysis to value the subject property. The Respondent correctly notes that the DCF analysis is an assumption-laden approach that is prone to errors. Indeed USPAP's *Statement on Appraisal Standards No. 2* ("Statement 2") cautions "[b]ecause DCF analysis is profit oriented and dependent on the analysis of uncertain future events, it is vulnerable to misuse." *Ex. P8 at 82*. Thus, USPAP's Standards Rules 1-1(b) and 1-1(c), requiring appraisers to avoid making substantial errors or rendering appraisal services in a negligent manner, have special significance for appraisers performing a DCF analysis "because of the potential for the compounding effect of errors in the input, unrealistic assumptions, and programming errors." *Id*. For those reasons, Statement 2 concludes that DCF analysis "is best applied in developing value opinions in the context of one or more other approaches." *Id.*

48. Despite USPAP's warnings, Mr. Johns relied solely on a DCF analysis to value the subject property. And his application of the DCF analysis highlights precisely the dangers identified in Statement 2. Mr. Johns used a 25-year holding period, virtually guaranteeing that even small projection errors would significantly affect his ultimate value estimate. Given that danger, it was incumbent upon Mr. Johns to clearly support his assumptions.

49. Unfortunately, Mr. Johns provided only conclusory explanations for several key assumptions. For example, the subject property's reversion value was the largest income source that Mr. Johns identified. In projecting the reversion's undiscounted terminal-year value, however, Mr. Johns assumed that the property's year-1 value would appreciate at an annual rate of only 1%. Mr. Johns's assumption yielded a very low terminal-year value in absolute terms. But it also led Mr. Johns to calculate an extremely long holding period. Because Mr. Johns then discounted the already low reversion value over a 25-year holding period, any potential distortion was magnified. Despite those significant dangers, Mr. Johns did not explain his basis for projecting such a minimal annual-

appreciation rate. At best, he stated, "[g]iven the economic and demographic data for the community, it is not likely rents increased much during [1999 to 2002]." *Ex. P1 at 28*.

50. Equally as troubling, Mr. Johns did not project an annual-income stream for the subject property. Mr. Johns assumed that the Petitioner would not be eligible for RTO, because it would not fully fund its reserve account. *Ex. P1 at 24-26, 38-39*. The reserve account's balance as of March 1, 2002, lends at least some support to Mr. Johns's assumption. *Id*. But the RTO restrictions do not mean that the subject property was not generating any income. Indeed, the property was generating sufficient income for the Petitioner to service its mortgage. Mr. Johns, however, simply noted that debt-service was one of the expenses that Rural Development allowed in determining the Petitioner's budget, and he did not thereafter account for income devoted to debt service in years 1 through 24 of his DCF analysis.

51. Mr. Johns did not demonstrate that he complied with generally accepted appraisal principles when he ignored income devoted to debt service. In fact, his actions appear to violate basic concepts underlying the income-capitalization approach. That approach is based upon how potential investors value real property. *See* MANUAL at 14. And investors generally finance real estate purchases through a mix of debt and equity. The Petitioner itself financed the subject property's purchase and development largely through subsidized mortgage loans from Rural Development. The amount that an investor will pay for a property therefore depends partly on the debt service that the property's income stream will support. Mr. Johns himself apparently recognized that fact elsewhere in his analysis. Thus, he did not subtract debt service as an expense when he capitalized the subject property's net income to estimate its year-1 reversion value. *Ex. P1 at 30-32*.

52. By failing to include income used for debt service, Mr. Johns also ignored the definition of true tax value upon which Indiana's real-property-assessment scheme is based. As explained above, the Manual defines true tax value as "[t]he market value-in-use of a property for its current use, as reflected by the utility received by the owner or a similar

user." MANUAL at 2. The Petitioner receives substantial utility from the subject property in the form of income sufficient to service approximately $600,000 in debt. Mr. Johns himself essentially acknowledged that fact when he stated: "This conversion from subsidized to market housing is considered to be financially feasible when the existing [Rural Development] loan balance is less than the Reversionary income. . . . To sell the property before this point would not be prudent, as *the owner would then have to use his own cash to pay off the remaining balance not covered by the reversionary income*." *Ex. P1 at 25* (emphasis added).

53. Finally, Mr. Johns's decision to ignore the Rural Development interest subsidy in valuing the subject property conflicts with Indiana law. Mr. Johns grounded his decision on his belief that true tax value does not include the value of intangible assets, saying:

> [USPAP] Standards Rule 1-4(g) requires that the value of intangible assets be considered in the total value of the property when the intangible assets are significant to overall value. Since True Tax Value must not include the value of intangible assets, no separate valuation of the [Rural Development] Subsidized Financing is required, and would serve no purpose in this appraisal.

Ex. P1 at 11.

54. The Indiana Tax Court, however, rejected a similar claim in *Hometowne Associates, L.P. v. Maley*, 839 N.E.2d 269 (Ind. Tax Ct. 2005). In that case, the taxpayer sought an obsolescence adjustment for a property that qualified for low-income-housing tax credits under section 42 of the Internal Revenue Code. 839 N.E.2d at 271. Like Section-515 properties, properties in the low-income-housing tax credit ("LIHTC") program are subject to rent and use restrictions. *Id.; see also Pedcor Investments-1990-XIII, L.P. v. State Bd. of Tax Comm'rs*, 715 N.E.2d 432, 438 (Ind. Tax Ct. 1999). To entice private developers into agreeing to those restrictions, Section 42 provides tax credits that can be sold to investors in a limited partnership and used to offset their federal-income-tax liabilities. *Hometowne Associates*, 839 N.E.2d at 272. The developer then uses the sale proceeds as equity financing. *Id.*

55. The taxpayer in *Hometowne Associates* offered alternate calculations to support its obsolescence claim. In its first calculation, the taxpayer quantified obsolescence without reference to its tax credits. *Id*. at 276. The taxpayer justified excluding the tax credits from its calculation by arguing that they were intangible property. *Id*. at n. 11. The taxpayer also presented a second calculation in which it accounted for the tax credits' value in the event the court rejected its primary claim. *Id.* at 275-76.

56. The court noted that it had previously aligned itself with jurisdictions holding that federal tax incentives must be considered when evaluating whether rental restrictions cause low-income-housing complexes to experience obsolescence. *Id*. at 280 n. 17 (citing *Pedcor*, 715 N.E.2d at 432, 437 n. 10). The court then expressly rejected the taxpayer's claim that its tax credits were intangible property that could not be considered in assessing real property. 839 N.E.2d at 280 n. 17.[5]

57. While the incentive at issue in this case is an interest subsidy rather than a tax credit, the Tax Court's holding in *Hometowne Associates* controls. Each incentive is designed to make property owners agree to use restrictions. Similarly, each incentive is tied to the taxpayer's property and to its continued use as low-income housing. And neither incentive has value independent of the real property to which it is tied, constitutes a right to the payment of money, or is freely transferable upon receipt. *See Rainbow Apts. v. Ill. Prop. Tax Appeal Bd.*, 762 N.E.2d 534, 537 (Ill. Ct. App. 2001)(cited with approval in *Hometowne Associates,* 839 N.E.2d at 280 n. 17); *see also Johns testimony* (indicating that the Rural Development interest subsidy is tied to the land and cannot be sold separately).

58. Thus, in a decision that the Indiana Tax Court cited with approval, the Supreme Court of Michigan rejected a taxpayer's claim that taxing authorities could not consider a

---

[5] In 2004, the Indiana General Assembly added Ind. Code § 6-1.1-4-40, which provides: "The value of federal income tax credits awarded under Section 42 of the Internal Revenue Code may not be considered in determining the assessed value of low income housing tax credit property." P.L. 81-2004, SEC.58. That section became effective on March 1, 2004. *Id.* Thus, it does not limit the Tax Court's holding in *Hometowne Associates* as applied to assessments before that date.

mortgage subsidy under Section 236 of the National Housing Act in valuing a low-income-housing project because the subsidy was an intangible. *Meadowlanes Ltd. Dividend Housing Ass'n v. City of Holland,* 473 N.W.2d 636, 647 (Mich. 1991); *Pedcor*, 715 N.E.2d at 437 n. 10. While the Michigan Supreme Court agreed that the subsidy was an intangible and therefore could not itself be taxed, the court held that the subsidy influenced value and should be considered in the same manner as tax benefits, location, zoning, and other intangible influences. *Meadowlanes*, 473 N.E.2d at 647. Indeed the Indiana Tax Court has also held that taxpayers must account for the benefits from Section-236 interest subsidies in calculating obsolescence caused by corresponding rent restrictions, although the court did not directly address whether the subsidy was intangible property. *Meadowbrook North Apts. v. Conner*, 854 N.E.2d 950, 956 (Ind. Tax Ct. 2005).

59. In light of the flaws described above, Mr. Johns's appraisal is insufficient, by itself, to support the Petitioner's claim that the subject property should be assessed for $62,800. But Mr. Johns's appraisal is not the only valuation evidence in the record. The Respondent also submitted an appraisal performed by its own experts — the Mordoh appraisers. And they estimated the subject property's market value to be $233,100 less than its current assessment.

60. As explained above, the Respondent argues that the Board should not consider the Mordoh appraisal because it was the Petitioner's burden to establish a prima facie case. As also explained above, however, the Board considers the record as a whole to determine whether the evidence preponderates in favor of a reduction in assessment. The Board therefore turns to the Mordoh appraisal.

61. The Mordoh appraisal has its own substantial flaws, many of which Mr. Johns highlighted in his testimony and review appraisal. For example, the Mordoh appraisers did not account for significant restrictions posed by the Section-515 program, such as the limitation on the Petitioner's RTO. And it is unclear whether they accounted for the Section-515 rent restrictions. On page 9 of their appraisal, the Mordoh appraisers

indicate that they used actual rents from the subject property in computing the property's value under the income approach. *Ex. R1 at 9*. Page 10, however, indicates that the appraisers used actual income and expenses from "Cambridge Square operations." *Id. at 10.*

62. Had the Mordoh appraisers relied on the sales-comparison analysis in reaching their final value estimate, and had they established that the comparable sales upon which they based that analysis had similar restrictions, one might argue that the Mordoh appraisal adequately accounted for the Section-515 restrictions. But the Mordoh appraisers indicated that their sales-comparison analysis was not "a good indicator of value," due to the lack of "specific comparables in the Bedford area." *R1 at 7*. And they did not establish that the comparable properties they relied upon were part of the Section-515 program or burdened with comparable restrictions.

63. The flaws in the Mordoh appraisal, however, led the appraisers to overstate — not understate — the subject property's market value-in-use. And despite the failings of Mr. Johns's appraisal, the Board is convinced that the Section-515 restrictions significantly affect the subject property's market value-in-use. Thus, based upon the record as a whole, the Board finds that the subject property's true tax value does not exceed $585,000 — the amount estimated in the Mordoh appraisal.

SUMMARY OF FINAL DETERMINATION

64. Based on a preponderance of the evidence, the Board finds that the current assessment is incorrect and that the correct assessment should not exceed $585,000. The Board therefore orders that the subject property's assessment be changed to no more than $585,000.

This Final Determination of the above captioned matter is issued this by the Indiana Board of Tax Review on the date first written above.

____

Commissioner, Indiana Board of Tax Review

IMPORTANT NOTICE

- Appeal Rights -

You may petition for judicial review of this final determination under the provisions of Indiana Code § 6-1.1-15-5, as amended effective July 1, 2007, by P.L. 219-2007, and the Indiana Tax Court's rules. To initiate a proceeding for judicial review you must take the action required within forty-five (45) days of the date of this notice. The Indiana Tax Court Rules are available on the Internet at <http://www.in.gov/judiciary/rules/tax/index.html>. The Indiana Code is available on the Internet at <http://www.in.gov/legislative/ic/code>. P.L. 219-2007 (SEA 287) is available on the Internet at <http://www.in.gov/legislative/bills/2007/SE/SE0287.1.html>