REPRESENTATIVE FOR PETITIONERS:
Brad Hasler, BINGHAM McHALE, LLP

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

BEFORE THE
INDIANA BOARD OF TAX REVIEW

Mitchell Limited, d/b/a, Elm Park I & Mitchell Limited II d/b/a Elm Park II	)	Petition Nos.: 47-012-02-1-5-00033 47-012-02-1-5-00034
Petitioners,	)	Parcels: 1200130800 1200171200
v.	)	County: Lawrence Township: Marion
Marion Township Assessor,	)	
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 these appeals upon the Petitioners concluding their 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 Petitioners introduced in their 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 Petitioners' 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 Petitioners have met their burden of proof.

Issue II

3. The subject properties are part of a federal low-income-housing program under which the Petitioners received subsidized mortgage loans in exchange for agreeing to various restrictions on the properties' use. The Petitioners submitted appraisals that relied solely on a discounted-cash-flow analysis in which the appraiser considered the properties' restrictions but not the federal interest subsidies. The Respondent, by contrast, submitted an appraisal valuing the subject properties for more than their current assessments, although its appraisers ignored several of the properties' use restrictions. The Board therefore must consider whether based on the record as a whole, the Petitioners demonstrated their entitlement to a reduction in the subject properties' assessments, and if so, what the reduced assessments should be.

4. The Petitioners did not carry their burden of proof. The Petitioners' appraisals lack 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 Petitioners' debt. 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. Because the Respondent's appraisal, though flawed, estimated the subject properties' values to be higher than their assessments, that appraisal likewise does not aid the Petitioners' case.

PROCEDURAL HISTORY

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

6. The above-captioned appeals present issues similar to those presented in three 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 that was specific to the individual apartment complexes, the Board will issue separate final determinations.

7. The following persons were sworn in as witnesses:

For the Petitioners:

Edwin K. DeWald, DeWald Property Tax Services
Randall Warner, DeWald Property Tax Services

[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.

Phillip D. Johns, The Value Company

For the Respondent:

Kirk Reller, Technical Advisor for the County and Townships
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 following exhibits were presented for the Petitioners:

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

10. The following exhibit was presented for the Respondent:

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 for each parcel
Board Exhibit B – Notice of Hearing for each parcel
Board Exhibit C – Hearing Sign-In Sheet

12. The subject properties are two phases of an apartment complex known as Elm Park I & II. Elm Park I is located on Orchard Street and Elm Park II is located on Elm Park Drive in Mitchell, Indiana.

13. The ALJ did not inspect the subject properties.

14. For 2002, the PTABOA determined the assessed value of the properties to be:

	Land	Improvements	Total
Elm Park I	$81,000	$704,100	$785,100
Elm Park II	$56,700	$669,400	$726,100

15. At the hearing, the Petitioners requested the following assessments:

	Land	Improvements	Total
Elm Park I	$81,000	$0	$81,000
Elm Park II	$57,600	$0	$57,600[2]

MOTION TO DISMISS

16. Upon the Petitioners concluding their case-in-chief, the Respondent moved to dismiss the appeals contending that the Petitioners failed to make a prima facie case. The Petitioners 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 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

[2] The Petitioner requested the following assessments on its Form 131 petitions:

	Land	Improvements	Total
Elm Park I	$81,000	$392,200	$473,200
Elm Park II	$56,700	$380,900	$437,600

proof completes its case-in-chief. If, however, the movant 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 Petitioners are relieved of their burden of proof; rather, the Board will consider the record as a whole — not just the evidence presented in the Petitioners' case-in-chief — in determining whether the Petitioners met their burden.

ADMINISTRATIVE REVIEW AND THE PETITIONERS' 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

Findings of Fact

22. Elm Park I is a 32-unit apartment complex built in 1984. *Ex. P2 at 4*. Elm Park II is a 24-unit apartment complex built in 1988. *Ex. P3 at 4*. Both properties are 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 Petitioners financed 95% of each complex's original cost through mortgage loans from Rural Development. *Ex. P2 at 9-10; Ex. P3 at 9-10*. Rural Development provides a credit to reduce the Petitioners' interest payments to 1% of the principal loan amounts, and the loans are amortized over 50 years. *Id*. The Petitioners did not disclose their original loan amounts, but as of March 1, 2002, the unpaid loan balance on Elm Park I was approximately $916,000 and the unpaid loan balance on Elm Park II was $697,000 *Ex. P2 at 38; Ex. P3 at 38.*

23. In exchange for those favorable loan terms, the Petitioners agreed to subject their properties to several restrictions. The Petitioners must lease their apartments to qualified low-income tenants for the life of the loan. *Ex. P2 at 9-10; Ex. P3 at 9-10*. The Petitioners must also complete annual budgets for Rural Development's approval. Rural Development uses those budgets to set rent levels. *Ex. P2 at 24; Ex. P3 at 24.* Rural Development applies a formula premised on the notion that, after allowing all approved expenses, including debt service, the subject properties' net income should be at or near zero. *Id*. If, however, net income exceeds 20% of the properties' operating and maintenance expenses, Rural Development may revise the following year's budget by decreasing rents, or, as is more likely, the Petitioners may transfer the excess into reserve accounts that Rural Development requires the Petitioners to maintain. *Id.* The Petitioners must fund their reserve accounts with annual payments equal to 1% of the original loans. *Ex. P2 at 24, 31*; *Ex. P3 at 24, 31*. The accounts are fully funded when their balances reach 10% of the original loans. *Id*.

24. If the Petitioners are on track to fully fund their reserve accounts, they 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 Petitioners' initial equity investment in each property. In Elm Park I's case, the RTO is capped at $3,928 per year. *Ex. P2 at 25*. Elm Park II's RTO is capped at $3,070 per year. *Ex. P3 at 25*. The Petitioners may deposit any additional revenue in excess-cash accounts. The excess-cash accounts' ending balances cannot exceed 20% of each property's operating and maintenance costs. *Ex. P2 at* 26; *Ex. P3 at 26*. If that happens, Rural Development typically lowers rents in subsequent years until the accounts no longer exceed their limits. *Johns testimony*. As of March 1, 2002, Elm Park I's excess-cash account's maximum-allowable ending balance was $11,364 and its actual cash-account balance was approximately $2,200. *Ex. P2 at 26.* Elm Park II's maximum-allowable ending balance was $9,902 and its actual balance was approximately $2,000. *Ex. P3 at 26*.

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. P2 at 10; Ex. P3 at 10.*

26. The Petitioners submitted appraisals prepared by Mr. Phillip Johns, a certified general appraiser with 19 years experience. *Johns testimony; Ex. P2 at 2; Ex. P3 at 2.* Mr. Johns worked for Rural Development for over two years. *Johns testimony; Ex. P2 at 42; Ex. P3 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 properties. *Johns testimony; Ex. P2 at 14*; *Ex. P3 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 properties. *Johns testimony; Ex. P2 at 11, 23-41; Ex. P3 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 properties suffered from "enormous" depreciation. *Johns testimony; Ex. P2 at 11; Ex. P3 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. P2 at 23; Ex. P3 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 properties rather than simply capitalizing one year of each 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. P2 at 24, 38; Ex. P3 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, selling the subject properties will be feasible when the properties' reversions — which he defined as the properties' market value as conventional apartment complexes — plus their RTO and account balances, exceed the

Petitioners' outstanding mortgage-loan balances. *Johns testimony; Ex. P2 at 38; Ex. P3 at 38.*

31. To determine the subject properties' March 1, 2002, reversions, Mr. Johns capitalized their stabilized net operating incomes as if they were conventional apartment complexes. *Johns testimony; Ex. P2 at 26; Ex. P3 at 26*. He determined their projected rental incomes and an appropriate vacancy- and collection-loss rate based upon a 1999 market study and 2000 census data, although he adjusted the latter due to poor economic conditions in Mitchell as compared to the rest of Lawrence County. *Johns testimony; Ex. P2 at 27-32; Ex. P3 at 27-32.* And he estimated the properties' operating expenses for 2002 based upon their actual expenses from 2000 and 2001. *Id.* He did not include debt-service as an operating expense. *Ex.P2 at 30; Ex. P3 at 30*. Mr. Johns ultimately calculated the subject properties' respective net operating incomes to be $37,295 and $25,424, respectively. *Johns testimony; Ex P2 at 32; Ex. P3 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. P2 at 33; Ex. P3 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, given the subject properties' physical characteristics, location, and use restrictions, an appropriate OAR for each property was between 11% and 13%. *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. P2 at 33-37; Ex. P3 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.* He also assumed that, given Mitchell's poor economy, expenses would increase faster than rents, which caused him to add .052 to his basic rate. *Id.* Thus, Mr. Johns determined an OAR of 9.9%, to which he added the subject properties' tax rate to arrive at an adjusted OAR of 12.2% for each property. *Id.*

34. Mr. Johns used the 12.2% OAR to capitalize the subject properties' stabilized net-operating income and arrived at 2002 reversion values of $306,000 for Elm Park I and $208,000 for Elm Park II. *Johns testimony; Ex. P2 at 38; Ex. P3 at 38.* Those reversion values, even when combined with the reserve- and cash-account balances, were substantially less than the properties' March 1, 2002, loan balances of approximately $916,000 and $697,000, respectively. *Id.* Thus, Mr. Johns determined that it would not have been feasible for the Petitioners to sell the subject properties in 2002. *Id.* According to Mr. Johns, it would only be feasible to sell those properties when the sum of each property's reversion value, account balances and RTO exceeds the Petitioners' loan balances. *Id.* Assuming that the subject properties' reversion values would decrease by 1% annually, Mr. Johns determined that the first feasible sale date for Elm Park I would be in the year 2032 and that the first feasible sale date for Elm Park II would be in the year 2035. *Id.* Mr. Johns therefore determined that a DCF analysis was appropriate for each property.

35. In his DCF analyses, Mr. Johns applied a discount rate to two potential income sources for each property — the Petitioners' annual 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. P2 at 24-26, 38-39; Ex. P3 at 24-26, 38-39.* Mr. Johns used a holding period equal to the number of years

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

between the March 1, 2002, assessment date and the feasible sale date for each property. Thus, he used a 31-year holding period for Elm Park I and a 34-year holding period for Elm Park II. *Id*. Mr. Johns applied an annual-discount factor of 11.38%, which he obtained from Valuation Insights & Perspectives. Based on that process, Mr. Johns arrived at discounted present values of $45,000 for Elm Park I and $32,000 for Elm Park II. *Id*.

36. Mr. Johns, however, conceded that his estimates were less than the properties' land assessments of $81,000 and $57,600, respectively. *Johns testimony; Ex. P2 at 41; Ex. P3 at 40.* According to Mr. Johns, the subject buildings detract from the properties' values 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 improvements. *Id.* Thus, in Mr. Johns's opinion, the value of the improvements should be reflected as $0 for each property, leaving Elm Park I's true tax vale at $81,000 and Elm Park II's true tax value at $57,600. *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. R3*. 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 looked at all three generally accepted value approaches. Under the income-capitalization approach, the Mordoh appraisers used the actual 1999 rents and expenses from the subject properties, and they estimated the properties' vacancy and collection losses at 5% of projected gross income. *Ex. R3 at 12-15*. The Mordoh appraisers ultimately estimated net operating income of $38,908 for Elm Park I and $38,689 for Elm Park II. *Id. at 12, 14*. The appraisers' calculations for Elm Park II, however, are confusing, at best. On page 14 of the appraisal, the Mordoh appraisers appear to have based their calculations on Elm Park II having 14 one-bedroom units and 18 two-bedroom units, whereas it actually has 8 one-bedroom units and 16 two-bedroom

units. *Ex. R3 at 2, 14*. And when it came time to capitalize Elm Park II's net income, they used net income of $31,585 instead of the $38,689 they determined in their net-income analysis. *Ex. R3 at 15*. The Mordoh appraisers did not explain that discrepancy.

39. The Mordoh appraisers used an OAR of 10.89% to capitalize each property's net operating income. *Ex. R3 at 13, 15*. They determined their OAR using a band-of-investment analysis, assuming a 75% loan-to-value ratio, an 11.19% mortgage constant, which they based on a loan at 9% interest amortized over 20 years, and a 10% equity-yield *Id*. The appraisers did not explain the basis underlying their choice of financing terms and equity yield. *See id.; see also Mordoh testimony*.

40. For their sales-comparison approach, the appraisers relied upon property sales from Huntingburg, Paoli and Bedford, Indiana. *Id. at 10-11*. The Mordoh appraisers made a few adjustments to the comparable properties' sale prices. Although they did not explain any individual adjustment, they said that they based their adjustments as a whole on their "long term experience and expertise and analysis of the market data over the years." *Id. at 9*. Based on the comparable properties' adjusted sale prices, the Mordoh appraisers estimated Elm Park I's market value at $908,800 and Elm Park II's market value at $756,000. *Id. at 10-11*.

41. The Mordoh appraisers found that the sales-comparison approach yielded the best estimate of the subject properties' market value. *Ex. R3 at 16*. The appraisers acknowledged that there were "no actual comparables in the Mitchell market to support selling at this price per unit locally." *Id. at 9*. Nonetheless, the Mordoh appraisers found that the value per unit may be similar throughout small towns in Southern Indiana, and that relying on values derived from sales in Bedford, Paoli and Huntingburg could be considered if other values were unreliable. *Id*. And they found their conclusions under the income-capitalization approach to be unreliable because the subject apartments were leased at below-market rents and their operating expenses appeared to be excessive. *Id. at 16*. The Mordoh appraisers therefore concluded that the sales-comparison approach

was the best indication of the subject properties' values and they estimated the properties' combined market value at $1,600,000 as of January 1, 1999. *Id.*

42. Mr. Johns prepared a written review of the Mordoh appraisal analyzing whether it complied with USPAP. *Ex. P10.* Mr. Johns concluded that the Mordoh appraisal did not comply with USPAP in several respects. *Johns testimony; Ex. P10 at 7-15.* For example, the Mordoh appraisers failed to recognize that the subject properties were part of the Section-515 program, which placed significant restrictions upon their 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.*

43. Mr. Johns also identified what he claimed were various factual errors in the Mordoh appraisal. For example, 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, USPAP's latest edition does not use the terms "limited" and "complete" when referring to appraisal reports. *Id.* Finally, Mr. Johns questioned why the Mordoh appraisers relied upon the sales-comparison approach to value the subject properties when they found that approach meaningless in valuing the Pines of Bedford, another Section-515 property. *Id. at 14.* The Mordoh appraisers justified their decision on grounds that rents were too low and expenses too high, but they did not present any data to support their claims. *Id.*

Discussion

44. 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").

45. 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.

46. The Petitioners rely on Mr. Johns's appraisals. 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*.

47. The Respondent, however, contends that Mr. Johns's appraisals are not probative of the subject properties' market values-in-use, and that the Petitioners therefore failed to make a prima facie case. First, the Respondent contends that Mr. Johns did not appraise the subject properties based on their current uses, but rather upon their projected uses more than 30 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 appraisals are rife with unsupported assumptions that greatly affect his value estimates.

48. The Board agrees that Mr. Johns's appraisals suffer from significant flaws that detract from their probative value. Several of those flaws are closely tied to Mr. Johns using a DCF analysis to value the subject properties. 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.*

49. Despite USPAP's warnings, Mr. Johns relied solely on a DCF analysis to value the subject properties. And his application of the DCF analysis highlights precisely the dangers identified in Statement 2. Mr. Johns used holding periods of over 30 years, virtually guaranteeing that even small projection errors would significantly affect his ultimate value estimates. Given that danger, it was incumbent upon Mr. Johns to clearly support his assumptions.

50. Unfortunately, Mr. Johns provided only conclusory explanations for several key assumptions. For example, the reversion value was the largest income source that Mr. Johns identified. In projecting the reversion's undiscounted terminal-year value for each property, however, Mr. Johns assumed that the property's year-1 value would depreciate at an annual rate of 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 such a long holding period, any potential distortion was magnified. Despite those significant dangers, Mr. Johns did not explain his basis for projecting that each property's reversion

value would steadily depreciate over time. At best, he stated, "[g]iven the economic and demographic data for the community, it is not likely rents increased during [1999 to 2002]." *Ex.P2 at 28; Ex. P3 at 28.*

51. Equally as troubling, Mr. Johns did not project an annual-income stream for the subject properties other than their limited RTO. But the RTO limits do not mean that the properties were generating no other income. Indeed, the properties were generating sufficient income for the Petitioners to service their mortgages. But Mr. Johns simply noted that debt-service was one of the expenses that Rural Development allowed in determining the Petitioners' budgets, and he did not thereafter account for income devoted to debt service in years 1 through 30 and 1 through 33 of his DCF analyses.

52. Mr. Johns, however, 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 Petitioners themselves financed the subject properties' 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 properties' net incomes to estimate their year-1 reversion values. *Ex. P2 at 30-32; Ex. P3 at 30-32*.

53. 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 Petitioners receive substantial utility from the subject properties in the form of income sufficient to service mortgage loans with outstanding

balances of $916,000 and $617,000, respectively. 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. P2 at 25; Ex. P3 at 25* (emphasis added).

54. Finally, Mr. Johns's decision to ignore the Rural Development interest subsidies in valuing the subject properties 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. P2 at 11; Ex. P3 at 11.

55. 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.*

56. 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.

57. 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.[4]

58. While the incentive at issue in this case is an interest subsidy rather than tax credits, 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 real property and to its continued use as low-income housing. And neither incentive has value independent of the real property, 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, supra*, 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).

59. 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 an interest subsidy under Section 236 of the National Housing Act in valuing a low-income-housing

[4] 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.

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).

60. In light of the flaws described above, Mr. Johns's appraisals are insufficient, by themselves, to support the Petitioners claim that the subject properties should be assessed for $81,000 and $57,600, respectively. And the only other valuation evidence in the record is the Mordoh appraisers' opinions, which actually exceed the subject properties' current assessments. Those opinions themselves suffer from numerous flaws, including several identified by Mr. Johns in his review appraisal. Chiefly, the Mordoh appraisers did not address important restrictions on the properties, such as the limits on the Petitioners' RTO.

61. Given the Section-515 use restrictions, it is possible that that the subject properties are assessed for more than their market values-in-use. The record, however, lacks probative evidence to show with any reasonable degree of reliability how much above their market values-in-use the subject properties are assessed. This case therefore differs from *Pines Apartments v. Shawswick Twp. Assessor,* one of the companion cases heard with the Petitioners' appeals. There, the Mordoh appraisers' valuation opinion was itself less than the appealed property's assessment, and the Board concluded that the property's market value-in-use was no more than what the Mordoh appraisers estimated. The Mordoh appraisal, which the Board found was likely too high, at least set a ceiling on the appealed property's market value-in-use. In this case, by contrast, the ceilings set by the

Mordoh appraisers do the Petitioners no good, because they are higher than the existing ceiling set by the Respondent's assessments.

SUMMARY OF FINAL DETERMINATION

62. The Petitioners failed to establish that they were entitled to a change in their assessments. The Board therefore finds for the Respondent and orders that that the assessments should not be changed.

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

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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>