

REPRESENTATIVES FOR PETITIONER:

James F. Beatty, Landman & Beatty  
Donald D. Levenhagen, Landman & Beatty

REPRESENTATIVE FOR RESPONDENT:

Marilyn S. Meighen, Nexus Group

**BEFORE THE  
INDIANA BOARD OF TAX REVIEW**

BBR – VISION III, LP	)	Petition Nos.: 70-011-06-1-4-00004
	)	70-011-07-1-4-00004
Petitioner,	)	70-011-08-1-4-00004
	)	
	)	Parcel No.: 700730427006000011
v.	)	
	)	County: Rush
	)	
RUSH COUNTY ASSESSOR,	)	Township: Rushville
	)	
Respondent.	)	Assessment Years: 2006, 2007, 2008

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

**October 24, 2011**

**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

### Introduction

1. The parties offered valuation opinions from three expert witnesses. The Board is ultimately persuaded by the opinions of BBR's experts, who explained their analyses in more detail and who gave more weight both to local market conditions and the subject property's position within that market than did the Assessor's expert.

### Procedural History

2. BBR filed notices with the Rush County Assessor contesting the subject property's assessments for 2006-2008. On November 5, 2009, the Rush County Property Tax Assessment Board of Appeals ("PTABOA") issued determinations denying BBR relief for all three years. Consequently, BBR timely filed Form 131 petitions with the Board. The Board has jurisdiction over BBR's appeals under Ind. Code §§ 6-1.1-15 and 6-1.5-4-1.
3. On April 28, 2011, the Board's Administrative Law Judge, Joseph Stanford ("ALJ"), held a consolidated administrative hearing on BBR's appeals. Neither the Board nor the ALJ inspected the subject property.
4. The following witnesses testified under oath:
  - David Bennett, co-owner, Bennett Bennett & Reindl Corporation
  - Jay E. Allardt, appraiser, American United Appraisal Company
  - Michael C. Lady, appraiser, Integra Realty Resources
  - Jeff Wuensch, Nexus Group
  - Richard H. Hoffman, appraiser, Appraisal Research Corporation
  - Mary Ann Bridges, Rush County Assessor<sup>1</sup>
5. The parties submitted the following exhibits:
  - BBR:

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<sup>1</sup> Leslie Weisenbach and Stacey Haberman were also sworn in, but they did not testify.

- Petitioner Exhibit 1: Assessor’s Response to Interrogatories
- Petitioner Exhibit 2: Deposition of JoAnne Herbert
- Petitioner Exhibit 3: Deposition of Jeffrey Wuensch
- Petitioner Exhibit 4: Deposition of Lana C. Boswell
- Petitioner Exhibit 5: Deposition of Frank Kelly
- Petitioner Exhibit 6: Declaration of Extended Rental Housing Commitment
- Petitioner Exhibit 7: Burns Ind. Code Ann. Sections 6-1.1-4-40 & 41
- Petitioner Exhibit 8: *Shelby’s Landing-II, LP v. Shelby County Assessor*, pet. nos. 73-002-06-1-4-72402 and -03 (Ind. Bd. Tax Rev. Feb. 3, 2010)
- Petitioner Exhibit 9: *Shelby County Assessor v. Shelby’s Landing-II, LP*, cause no. 49T10-1004-TA-17 (Ind. Tax Ct. Dec. 6, 2010).
- Petitioner Exhibit 10: Curriculum Vitae for Jay Allardt
- Petitioner Exhibit 11: Appraisal of The Village at Flatrock Apartments (“Allardt appraisal”)
- Petitioner Exhibit 12: Addenda to Appraisal of The Village at Flatrock Apartments
- Petitioner Exhibit 13: Deposition of Mary Ann Bridges
- Petitioner Exhibit 14: 3/28/11 e-mails between J.F. Beatty and Marilyn Meighen
- Petitioner Exhibit 15: Michael C. Lady, MAI – Curriculum Vitae
- Petitioner Exhibit 16: Median Income and Operating Costs for Apartments
- Petitioner Exhibit 17: National Apartment Association *2007 Survey of Operating Income & Expenses in Rental Apartment Properties*
- Petitioner Exhibit 18: Scott T. Simpson, *A New Proposal for Low-Income Multifamily Housing Valuation*, 6 Journal of Property Taxation, issue 3, p. 51
- Petitioner Exhibit 19: Summary Review Appraisal of Income Capitalization Approach as Contained in Appraisals of Real Property (“Lady appraisal”)
- Petitioner Exhibit 20: Petitioner’s Response to Assessor’s Response to Rebuttal

Assessor:

- Respondent Exhibit A: Appraisal of The Village at Flatrock Apartments (“Hoffman appraisal”)
- Respondent Exhibit B: Mortgage Note<sup>2</sup>
- Respondent Exhibit C: Assessor’s Response to Rebuttal

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<sup>2</sup> This exhibit was admitted over objection.

6. BBR did not provide the Assessor with copies of Petitioner’s Exhibits 16-19 before the Board’s hearing. Although the Assessor initially asked for a two-week recess to examine the exhibits, particularly Exhibit 19 (the Lady appraisal), she ultimately agreed to BBR’s proposal that she file a written response to those exhibits and to Lady’s testimony.<sup>3</sup> Based on that agreement, the ALJ gave the Assessor five business days to file a response. That response is labeled Respondent’s Exhibit C. BBR’s reply to that response is labeled Petitioner’s Exhibit 20.

7. The Board recognizes the following additional items as part of the record of proceedings:

- Board Exhibit A: BBR’s Form 131 petitions
- Board Exhibit B: Hearing notices
- Board Exhibit C: Hearing sign-in sheet

8. The PTABOA determined the following values for the subject property:

For March 1, 2006

Land: \$214,500      Improvements: \$2,882,400      Total: \$3,096,900

For March 1, 2007

Land: \$218,800<sup>4</sup>      Improvements: \$2,892,800      Total: \$3,111,600

For March 1, 2008

Land: \$218,800      Improvements: \$2,892,800      Total: \$3,111,600

### **Objection**

9. BBR objected to Hoffman’s appraisal (Resp’t Ex. A) and testimony, arguing that the Assessor failed to follow proper procedures in contracting with Hoffman. Specifically, BBR claimed that the Assessor violated Ind. Code §§ 6-1.1-4-17 and 6-1.1-4-18.5 by failing to solicit bids.

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<sup>3</sup> The Assessor also made a “qualified objection” to Exhibit 18, but indicated that the agreement to respond to BBR’s rebuttal evidence within five business days after the hearing took care of her concerns. Thus, the Board does not understand the Assessor to have actually objected to Exhibit 18. To the extent that she did, the Board overrules her objection.

<sup>4</sup> At hearing, there was some confusion regarding whether the March 1, 2007 land assessment was \$214,500 or \$218,800. The PTABOA decision is controlling, however, and it indicates a land assessment of \$218,800. *Bd. Ex. A.*

10. The Board overrules BBR's objection. It is not clear that the Board even has authority to review the statutory procedures for an assessor to enter into a professional services contract. Regardless, the statutes that BBR cites address contracting with appraisers to help perform assessments and reassessments. *See* Ind. Code §§ 6-1.1-4-17(a) and 6-1.1-4-18.5(a). BBR does not cite to any statute requiring an assessor to solicit bids when she hires an expert witness to appraise an individual property, as Hoffman did here. Even if the Assessor violated any statutory procedures for a governmental entity to hire an expert witness, the remedy would not be to exclude the witness's testimony.

### **Findings of Fact**

#### **A. The subject property**

11. The subject property is a 60-unit apartment complex known as The Village at Flatrock. It is located at 157 West Foster Heights Road in Rushville, Indiana. The buildings were completed in the first half of 2005 at a total cost of more than \$5,000,000. *Pet'r Ex. 11 at 44.*
12. BBR owns and operates the subject property under a Declaration of Extended Rental Housing Commitment ("Section 42 Agreement") by which BBR sought and received low income housing tax credits under Section 42 of the Internal Revenue Code. *See Bennett testimony; Pet'r Ex. 6.* Under Section 42, entities seeking to develop and build housing projects receive federal-income-tax credits in exchange for agreeing to restrictions on the income levels of tenants and the amount of rent that can be charged. Those tax credits can then be sold and the proceeds used as equity to finance building the project. *See Bennett testimony; see also, Pet'r Ex. 18 at 52.* The restrictions are typically for 15 years, which at least one witness referred to as the "compliance period." *Allardt testimony.* An owner, however, may agree to extend that compliance period, which BBR did for the subject property. *See Bennett testimony, Allardt testimony.* Thus, the subject

property's compliance period runs for 30 years. *Id.; Pet'r Ex. 11 at 44.* The Section 42 restrictions run with the land. *Id. at 5.* If an owner or operator violates the Section 42 rent and income restrictions during the compliance period, the federal government can recapture the tax credits. *Bennett testimony; Allardt testimony.* For that reason, Section 42 properties rarely transfer within the compliance period. *See Allardt testimony.*

13. As part of its Section 42 Agreement, BBR must reserve 11.67% of the subject property's units for households with 30% or less of the median area income, 51.67% of the units for households with 50% or less of the median area income, and 36.66% of the units for households with 60% or less of Rushville's median income. *Pet'r Ex. 6 at 3.* The Indiana Housing and Community Development Authority sets maximum rent levels for the subject property. *Bennett testimony; Pet'r Ex. 11 at 46.* Except for the 30%-of-median-income units, the subject property's restricted rents were actually at or above market level for the years at issue. *Allardt testimony; Pet'r Ex. 11 at 47.*

14. BBR also applied for and received an enterprise revitalization area deduction for the subject improvements, which the parties referred to as an "abatement." *Allardt testimony; Pet'r Ex. 11 at 58.* The abatement provides for the following amounts to be deducted from the assessments of the subject improvements over 10 years:

2005-pay-2006 – 100%  
2006-pay-2007 – 95%  
2007-pay-2008 – 80%  
2008-pay-2009 – 65%  
2009-pay-2010 – 50%  
2010-pay-2011 – 40%  
2011-pay-2012 – 30%  
2012-pay-2013 – 20%  
2013-pay-2014 – 10%  
2014-pay-2015 – 5%

*Pet'r Ex. 11 at 59.*

15. The parties offered appraisal reports and testimony from three appraisers. BBR hired Jay Allardt to appraise the subject property, while the Assessor hired Richard Hoffman to do

the same. BBR also hired Michael Lady and Leslie F. Weisenbach to review the appraisals by Allardt and Hoffman as well as to give their own valuation opinion. The Board therefore turns to the appraisers' respective valuation opinions.

### **B. Allardt's opinion**

16. Allardt is an Indiana certified general appraiser and a senior residential appraiser ("SRA"). *See Allardt testimony; Pet'r Ex. 10*. He has appraised various commercial properties over his career, including 12 Section 42 properties and other properties that receive federal subsidies. *Allardt testimony*.
17. Allardt certified that he appraised the subject property in conformity with the Uniform Standards of Professional Appraisal Practice. ("USPAP"), including USPAP's guidelines on retrospective value estimates. *Allardt testimony; Pet'r Ex. 11 at cover letter, 6-7*. As Allardt explained, retrospective appraisals are complicated by the fact that an appraiser already knows what happened in the market after the appraisal's effective date. *Id*. Nonetheless, data from after the effective date can be considered to confirm trends that reasonably would have been considered by a buyer or seller as of the effective date. *Id*.
18. Allardt estimated the subject property's value based on the property's physical condition and the condition of the market as of each March 1 assessment date at issue in these appeals. *Allardt testimony; Pet'r Ex. 11 at 78-79*. He then used two sets of data to trend each estimate to a value as of January 1 of the preceding year—changes in the consumer price index and changes to median income levels in Rush County—although he gave slightly more emphasis to the latter. *Id*.
19. Given the requirements of Indiana Code § 6-1.1-4-40 and -41 (*see infra*), Allardt based his conclusions on the income capitalization approach to value, although he did look at other things, like a comparison to the assessments of other Section 42 properties, as a "secondary check" on his conclusions. *Allardt testimony; Pet'r Ex. 11 at 65, 77*.

20. In applying the income capitalization approach, Allardt first examined the subject property's rent rolls for 2006-2008. He then looked at various properties that he believed were comparable to the subject property, including several conventional apartments and two subsidized properties—Loma Apartments, a property operated under another federally subsidized housing program know as “Section 515,” and Rushville Commons, which is rented to people with “Section 8” vouchers. *Pet'r Ex. 11 at 48*. Allardt also looked at other Section 42 properties, including one from New Castle, which is a small community like Rushville. *Allardt testimony*. Based on his analysis of those comparable properties, Allardt concluded that the subject property's rent rolls represented the market. *Id.* He therefore used the subject property's actual income. *Id.*
21. Allardt recognized that BBR collected less than the full amount of the subject property's potential gross income, which he attributed to several causes. For example, the subject property had competition, particularly from other subsidized apartment complexes in nearby communities. *Pet'r Ex. 11 at 49*. Also, BBR collected the lowest amount in 2007, when many people in the subject property's already limited prospective tenant pool were able to qualify for loans to buy single-family homes with little or no down payment. *Allardt testimony; Pet'r Ex. 11 at 48*. That led to a higher vacancy rate and to BBR offering rent concessions in some instances. *Id.* All that changed with the financial crisis in 2008. *See Allardt testimony*. Nonetheless, those market-driven occupancy fluctuations prompted Allardt to consider the property's income separately for each year instead of projecting a single stabilized income stream based on a three-year average. *Id.*
22. Allardt next looked at the subject property's expenses. Instead of taking each year's expenses separately, as he did with the property's income, Allardt used the property's average expenses from 2008-2010 (\$2,867 per unit). *Pet'r Ex. 11 at 50*. While that average included years after the assessment years at issue in these appeals, Allardt believed that the later years' expense data confirmed a trend that would have been apparent to market participants in the years at issue. *Allardt testimony*. Allardt felt that it was important to use stabilized expenses, and the first three years' expenses would not have reflected the property's likely expenses going forward. *See id.; see also, Pet'r Ex.*



*11 at 50.* For example, apartments do not turn over in the first year, so expenses associated with repainting and other maintenance that comes with such turnover would not have been realized. *Allardt testimony.* Based on statistics reflecting 45% to 55% annual turnover, Allardt explained that turnover-related expenses would not have stabilized at the subject property until roughly the middle of 2007. *Id.*

23. Allardt next compared the subject property's average expenses to the expenses for comparable Section 42 properties for 2006-2007. *Allardt testimony; Pet'r Ex. 11 at 51.* Those comparable properties bracketed the subject property in size, ranging from 30 to 98 apartments. *Pet'r Ex. 11 at 51.* The average and median expenses were \$2,763 per unit and \$2,789 per unit, respectively. *Id.* Two properties, one from Shelbyville and another from New Castle, were the most geographically comparable to the subject property. *Id.* Of those two, the 98-unit Shelbyville property was the most comparable because it included four-bedroom apartments. *Id.* The Shelbyville property had expenses of \$2,789 per unit. *Id.* According to Allardt, one would expect the subject property's expenses to be slightly higher because the Shelbyville property's fixed costs could be spread over a greater number of units. *Id.; Allardt testimony.* Thus, Allardt estimated expenses of \$2,850 per unit for the subject property. *Id.*
24. Significantly, Allardt explained that he excluded real estate taxes and replacement reserves when analyzing the both subject property's expenses and those of his comparable properties. *Allardt testimony; Pet'r Ex. 11 at 46.* He excluded taxes because they are a dependent variable; the amount of those taxes depends on the property's assessment, which is what is being litigated in these appeals. *See Allardt testimony.* Allardt instead accounted for taxes by "loading" the property's overall capitalization rate with the property's effective tax rate for each year. *Id; Pet'r Ex. 11 at 56.* Similarly, some of the comparable properties' financial information reflected reserves that were different from what they should have been. *Allardt testimony; Pet'r Ex. 11 at 46.* Thus, to maintain consistency, Allardt excluded reserves as an expense across the board. *See id.*

25. Allardt then turned his attention to determining an appropriate rate by which to capitalize the subject property's net income. Allardt cited to an appraisal treatise, *The Appraisal of Real Estate*, for the proposition that deriving an overall capitalization rate from the sales of comparable properties is preferred where sufficient data on the sales of similar, competitive properties is available. *Allardt testimony; Pet'r Ex. 11 at 53*. Allardt therefore focused on sales from smaller market areas, although most were still from towns bigger than Rushville. *Allardt testimony*. He analyzed the sales of 12 apartment complexes that sold between June 7, 2005, and November 26, 2008. *Id; Pet'r Ex. 11 at 54*. Allardt had appraised some of those properties. *Allardt testimony*. For the remaining properties, Allardt got information from other sources, including a cooperative of 56 appraisers who share information. *Allardt testimony*.
26. The average and median rates from Allardt's 12 sales were 9.67% and 9.65%, respectively. *Pet'r Ex. 11 at 54-55; Allardt testimony*. The comparable properties ranged in size from 32 to 146 units. *Id*. Although Allardt might not typically compare a 146-unit property to a 60-unit property like the subject property, the 146-unit property, Loper Commons in Shelbyville, was a Section 42 property. *Id*. Except for Loper Commons, each property was a conventional apartment, although some were older and therefore would tend to sell at prices yielding a higher overall rate. *Pet'r Ex. 11 at 55*. On the other hand, Allardt gave at least four reasons why he believed that, all other things being equal, a Section 42 property like the subject property would sell for a higher capitalization rate. First, the property is not very liquid because it would be very difficult to sell during its 30-year compliance period. *See Allardt testimony; see also Bennett testimony*. Second, the property is in a small market and has a limited tenant pool. *See Allardt testimony*. Third, BBR does not have the same flexibility as owners of conventional apartments. For example, BBR cannot raise rents to respond to demand. *Id*. Finally, everything that Allardt had read on the subject indicated that Section 42 apartments have less liquidity and more risk. *Id*.
27. For 2006, Allardt placed primary emphasis on the sale of Evergreen Manor from Seymour, which was very similar to the subject property in term of size and age (76 units

built in 1999). *Allardt testimony; Pet'r Ex. 11 at 55.* According to Allardt's appraisal report, Evergreen Manor sold for \$2,050,000 on June 30, 2005, which indicated an overall rate of 9.72%. *Pet'r Ex. 11 at 54.* He therefore concluded to an overall rate for the subject property of 9.75%. *Allardt testimony; Pet'r Ex. 11 at 55.*

28. On cross examination, Allardt was shown a listing sheet indicating that the seller in the Evergreen Manor transaction was motivated to sell due to developing new business interests and that the property had previously sold for \$3,100,000 in September 2001. *See Allardt cross-examination.* Allardt responded (1) that difference between the two sale prices was not that big,<sup>5</sup> and (2) that if the second sale was not valid, it would have been flagged and never would have been submitted.<sup>6</sup> *Allardt testimony.* In any case, Allardt admitted that he did not know all the facts about the Evergreen Manor sale and that illustrated why he did not rely exclusively on one sale. *Id.*
29. For his 2007 overall rate, Allardt relied on sales from 2006 and 2007. *Allardt testimony; Pet'r Ex. 11 at 55.* Also, national studies of investment-grade properties by *Korpacz* indicated that overall rates declined by .16 basis points (.16%) between the fourth quarter of 2005 and the fourth quarter of 2006. *Id.* Allardt therefore concluded to an overall rate of 9.5%. *Id.* For 2008, Allardt gave consideration to three sales from 2008, especially Loper Commons, and again concluded an overall rate of 9.5%. *Id.*
30. Allardt loaded his overall rates with the subject property's final effective tax rates for 2005 pay 2006 (2.829%), 2006 pay 2007 (2.964%), and 2007 pay 2008 (3.139%). *Allardt testimony; Pet'r Ex. 11 at 56.* Those rates were not what the BBR actually paid, however, because of the abatement of its improvements. *Allardt testimony; Pet'r Ex. 11 at 56-58.* Nonetheless, Allardt explained that considering the abatement in determining the property's capitalization rate would distort the property's value, because direct capitalization assumes the same income and expense characteristics in perpetuity,

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<sup>5</sup> In his testimony, Allardt referred to the second sale price as being for \$2,850,000 instead of the \$2,050,000 listed in his appraisal report. *Compare Allardt testimony with Pet'r Ex. 11 at 54.*

<sup>6</sup> The Board infers Allardt meant that his source would not have submitted information about the second sale if that sale was invalid.

whereas the abatement declines over 10 years and disappears. *Allardt testimony*. Indeed, the advent of “tax caps” in 2008 neutralized much of the abatement’s value. *See Allardt testimony; Pet’r Ex. 11 at 59*. After loading the overall rates, Allardt ended up with capitalization rates of 12.579%, 12.464%, and 12.639% for 2006, 2007, and 2008, respectively. *Pet’r Ex. 11 at 56*. He then capitalized the property’s net operating income for each year using those rates. *Id.; Allardt testimony*.

31. Allardt, however, did not ignore the abatement entirely. Instead, he found that the abatement was like receiving cash and that a buyer would therefore take the abatement into account. *Allardt testimony*. Thus, Allardt calculated the present value of the tax savings that that a buyer in each year under appeal would realize over the abatement’s remaining life, and came up with the following totals: \$43,226 (2006), \$24,061 (2007), and \$8,833 (2008), which he added to the property’s capitalized income for each year. *Allardt testimony; Pet’r Ex. 11 at 58-60*.

32. After adding the abatement’s present value, Allardt’s income-capitalization analysis yielded the following values:

- March 1, 2006: \$1,067,290
- March 1, 2007: \$941,672
- March 1, 2008: \$1,258,157

Allardt then trended each amount to a value as of January 1 of the preceding year to arrive at the following:

- January 1, 2005: \$1,045,000
- January 1, 2006: \$920,000
- January 1, 2007: \$1,230,000

*Pet’r Ex. 11 at 66, 77-79*.

### C. Hoffman's opinion

33. Hoffman is a certified general appraiser in Indiana and Ohio. *Hoffman testimony; Resp't Ex. A at 81-84.* Among other designations, Hoffman is a member of the Appraisal Institute ("MAI") and a Senior Member of the American Society of Appraisers. *Id.* He has been appraising property for almost 40 years and has appraised approximately 30 to 40 Section 42 properties. *Hoffman testimony.*
34. Like Allardt, Hoffman certified that he prepared his appraisal in conformity with USPAP. *Resp't Ex. at 77.* Hoffman considered all three approaches to value but relied only on the income approach. *Id. at 75-76; Hoffman testimony.* Under that approach, Hoffman analyzed the subject property from two perspectives: (1) using market rents, market expenses, and a capitalization rate for conventional apartments; and (2) using actual subsidized rents, expenses appropriate for Section 42 apartments, and a capitalization rate that reflects what he viewed as the lower risk of investing in Section 42 properties. *Hoffman testimony; Resp't Ex. A at 60.* Hoffman ultimately relied only on the second perspective. *Hoffman testimony; Resp't Ex. A at 69-74.*
35. Hoffman used the subject property's restricted rents to determine its potential gross rent, which he increased by 3% for "miscellaneous income." *Resp't Ex. A at 71.* From that total, Hoffman deducted vacancy and collection losses computed at 6% of the property's potential gross income. *Id.* He settled on that number based on data from a variety of sources, including the Institute of Real Estate Management, the Department of Housing and Urban Development, and the National Apartment Association. *Id.*
36. Hoffman considered the subject property's expenses and compared them with typical expenses for comparable properties, although he did not identify any of those comparable properties either in his appraisal report or his testimony. *See Hoffman testimony; Resp't Ex. A at 71.* Hoffman also relied on regionalized information from nationally published statistics on various types of subsidized apartments, including the National Apartment Association's *2007 Survey of Operating Income & Expenses in Rental Apartment*

*Communities*. Hoffman did so because, in his experience, expenses vary widely, and using individual properties' expenses makes an appraiser dependent on several factors, such as an owner's accounting methods, whether the owner uses different profit centers, and whether the owner is honest. *Hoffman testimony*. Hoffman ultimately settled on an expense ratio of 37% of effective gross income. *Hoffman testimony; Resp't Ex. A at 71*. That ratio yielded expenses, including replacement reserves but excluding real estate taxes, of \$123,406 or \$2,050 per unit. *See id.*

37. Hoffman's expenses are less than the subject property's actual operating expenses for any of the years at issue. *See Pet'r Ex. 11 at 50* (listing actual per-unit operating expenses, exclusive of reserves, of \$2,350, \$2,460, and \$2,953 for 2006-08); *see also Pet'r Ex. 19 at 17*. They are also less than the \$2,375 per unit listed in *2007 Survey of Operating Income and Expenses in Rental Apartment Properties* for the Indianapolis area. *See Pet'r Ex. 17 at 14*. Hoffman's expenses do roughly correspond to that survey's listed expenses for all subsidized garden apartments, at least when those expenses are expressed as a percentage of gross potential rent: the survey lists expenses of 35.8% excluding taxes and reserves, while Hoffman used expenses of 37% which excluded taxes but included 5% for reserves. *Id. at 21*. But the survey is based on gross potential rent of \$9,070 per unit compared to the subject property's gross potential rent of \$5,714 per unit. The operating expenses, excluding real estate taxes, listed in the survey are actually \$3,245 per unit, or \$1,195 more than what Hoffman estimated for the subject property. *See id.* When confronted with the survey on cross-examination, Hoffman said that it appeared to be the same as one of the sources that he had relied on, but that he could not respond to BBR's question about how he came up with his expenses in light of that data without going back to his files. *Hoffman testimony*.
38. Hoffman next turned to estimating an appropriate capitalization rate. In his report, Hoffman said that he considered rates that are prevalent in the market today for Section 42 housing, examined nationally published trends, and developed a "mortgage equity approach." *Resp't Ex. A at 71*. But Hoffman did not offer any information about those published trends. He similarly failed to explain how he developed his mortgage equity

approach or even what conclusions he drew from that approach. *See Hoffman testimony; Resp't Ex. A at 71-72.* Hoffman, however, did attach to his report a copy of the *Korpacz Real Estate Investor Survey National Market Indicators First Quarter 2008. Resp't Ex. A at 85.* For the first quarter of 2008, that survey shows overall rates ranging from 3.5% to 8.0% with an average of 5.79%. *Id.* The *Korpacz* survey gives a similar range and average for the fourth quarter of 2007. *Id.*

39. Hoffman settled on an overall rate of 7.1% for the subject property. *Resp't Ex. A at 71.* In justifying that rate, he relied, in part, on what he described as the decreased risk in investing in subsidized properties. *Id.; Hoffman testimony.* Hoffman recognized that Section 42 properties are not as liquid an asset as conventional apartments and that, as a rule of thumb, illiquidity tends to increase risk. *Hoffman testimony.* But Hoffman testified that liquidity is only one factor affecting risk and that, in his experience, Section 42 properties have less risk because they are largely financed with money generated from selling tax credits rather than with an investor's own money. *Hoffman testimony; Resp't Ex. A at 71.* Similarly, according to Hoffman, subsidized properties tend to have lower vacancy levels than conventional apartments, which also decreases risk. *Hoffman testimony.* Given that he estimated an overall rate of 8.9% when he applied the income capitalization approach from the perspective of conventional apartments, it appears that Hoffman gave significant weight to what he viewed as the decreased risk inherent in subsidized properties. *See Resp't Ex. A at 64-66.*
40. Like Allardt, Hoffman supplemented his overall rate with an additional rate to account for real estate taxes. Hoffman used a 1% "tax factor additur." *Hoffman testimony; Resp't Ex. A at 72.* To determine that additur, he divided the amount of taxes paid on the subject property by its assessment, which came to less than 1%. *Id.* Hoffman acknowledged that his additur took the property's abatement into account. *Hoffman testimony.*
41. Hoffman divided the property's net operating income by his 8.1% capitalization rate to arrive at a January 1, 2007 value of \$2,590,000. He then did a discounted cash flow analysis to account for the property's lease-up period and settled on the following values:

- January 1, 2007: \$2,590,000
- January 1, 2006: \$2,510,000
- January 1, 2005: \$2,360,000

*Hoffman testimony; Resp't Ex. A at 74, 78.*

#### **D. Lady's opinion**

42. At BBR's request, Michael C. Lady and Leslie F. Weisenbach of Integra Realty Resources prepared a summary review of the income capitalization analyses contained in the appraisal reports of Allardt and Hoffman. *Lady testimony; Pet'r Ex. 19 at cover letter.* Lady and Weisenbach also developed their own "Desk Review Market Value in Use Conclusions." *Pet'r Ex. 19 at cover letter.* They certified that they prepared their analyses, opinions, and report in conformity with USPAP. *Id. at 29.* Lady is a certified appraiser in seven states, including Indiana, and he has a number of designations and affiliations, including being an MAI and SRA. *Lady testimony; Pet'r Ex. 19.* Like Hoffman, Lady has been an appraiser for almost 40 years. *Lady testimony.* Leslie Weisenbach is a certified general appraiser in Indiana and South Carolina and is an MAI Associate Member of the Appraisal Institute. *Pet'r Ex. 19.* For ease of reference, the Board will refer to the Integra appraisers' joint opinion and analysis singularly as Lady's.
43. In comparing the Allardt and Hoffman appraisals, Lady found significant differences in effective gross income and expenses used by the two appraisers. *Lady testimony; Pet'r Ex. 19 at 18.* The difference in expenses was even more pronounced considering that Hoffman included replacement reserves while Allardt did not. *Lady testimony.* Lady believed that Hoffman's approach—simply quantifying expenses as a percentage of gross income—risks distorting those expenses. That is especially true when, as in Hoffman's appraisal, the data is taken from national publications, because one does not know the income characteristics of the properties on which those publications are based. *Id.* Indeed, the ratio of expenses to income is completely different in the Rushville market,



where median income is lower. *Id.* And the subject property has a hard time qualifying tenants because it is bound by restrictions of 30%, 50% and 60% of median income. *Id.*

44. Lady also found significant differences in the capitalization rates used by Allardt and Hoffman. *Lady testimony.* Lady noted that Allardt extracted his overall rate from sales of apartments in smaller communities. *Id.* Lady found that fact significant, because there is more risk in those communities than in larger communities that have bigger tenant pools. *Id.* By contrast, Hoffman did not provide any of the underlying data that he used in estimating his overall rate, and he failed to support his assumption of decreased risk for Section 42 properties. *Pet'r Ex. 19 at 19.* Lady was also troubled by Hoffman's "tax additur factor," which took the subject property's abatement into account. *Id.; Lady testimony.* That is because direct capitalization considers stabilized income and expenses over a given holding period. Unlike property taxes generally, which continue in perpetuity and therefore must be accounted for, an abatement goes away. *Lady testimony.* Although Lady believed that including the abatement would be circular because it is based on the property's assessment, which is the issue being litigated, if one were to consider the abatement at all, Allardt's approach would be an appropriate way to do so. *See id.*
45. For his own valuation opinion, Lady focused primarily on the subject property's March 1, 2007 value trended to January 1, 2006, because that is what he believed Hoffman did. *Lady testimony.* Lady estimated more effective gross income for the subject property than Allardt, but less than Hoffman. *Id.; Pet'r Ex. 19 at 18.* The main difference appears to be that Lady estimated vacancy and collection losses at 8% of potential gross income and concessions at 2%, which is much higher than the 6% vacancy and collection losses (without any allowance for rent concessions) used by Hoffman but lower than the property's actual vacancy and collection losses and concessions for two of the three years at issue. *See Lady testimony; see also, Pet'r Ex. 19 at 9-10, 18, 23, 26.* Lady based his vacancy-and-collection-loss estimate on a five-year average of vacancy and collection

losses at the subject property (8.13%) and on his view of the subject property's competitiveness within its submarket. *Pet'r Ex. 19 at 12.*

46. To estimate expenses, Lady used: (1) the subject property's actual history, (2) expense data from an operating apartment complex in Columbia City and budgeted expenses for two proposed complexes, and (3) industry benchmarks in the form of two publications from the Institute of Real Estate Management—one addressing conventional garden-type apartments in Indianapolis, and the other addressing federally assisted low-rise apartments in Indianapolis with 12-24 units. *Pet'r Ex. 19 at 13-17.* Lady examined that data for each of the following expense categories: insurance, utilities, repairs/maintenance, painting/decorating, payroll/benefits, advertising/marketing, general/administrative, and management. *Id.* Within those categories, Lady examined each source's expenses using three measures of comparison: percentage of effective gross income, dollars per square foot, and dollars per apartment unit. *Id.* Those expenses ranged from a low of \$2,424 per apartment or 47.5% of effective gross income for the industry benchmarks to a high of \$3,497 per apartment or 61.3% of effective gross income for the complex in Columbia City. *See id.* Based on that data, Lady estimated expenses of \$2,734 per unit for the subject property. *Id. at 17.*
47. Lady then turned to estimating an appropriate capitalization rate. He developed an overall rate that was very close to Allardt's. *Lady testimony; Pet'r Ex. 19 at 19.* In doing so, Lady considered the impact of the following characteristics of the subject property:
- Income characteristics—including occupancy stability and whether the property had above or below market rents.
  - Competitive position in the market—including the property's construction quality, appeal, condition, effective age, and functional utility.
  - Location—including market-area demographics and lifestyle trends, proximity issues, and access and support services.
  - Market—including vacancy rates and trends, rental rates and trends, and supply and demand.

- Highest and Best Use—including upside potential from redevelopment, adaptation and expansion.

*Lady testimony; Pet'r Ex. 19 at 20.* Other than the subject property's competitive position in the market, Lady determined that all of the factors tended to push the subject property's overall rate higher. *Id.* Lady settled on an overall rate of 9.5% which he loaded with the property's 2006 pay 2007 rate of 2.964% for a total capitalization rate of 12.464%. *Id.* That led Lady to a March 1, 2007 value of \$1,240,000. *Pet'r Ex. 19 at 20-21.*

48. Lady did not explain his conclusions for the other two years in as much detail. *See Pet'r Ex. 19 at 22-28.* Generally speaking, his income and expense estimates changed slightly for each year. *See id.* The main difference was in the loaded capitalization rate for each year. Although he used the same overall rate of 9.5%, the tax rate changed. *Id.*
49. Lady then used Allardt's trending factors to relate each March 1 value to a value as of January 1 of the previous year. Thus, Lady estimated the following values for the subject property:
- January 1, 2007: \$1,280,000
  - January 1, 2006: \$1,210,000
  - January 1, 2005: \$1,200,000
- Lady testimony; Pet'r Ex. 19 at 1, 21-28.*

### **Conclusions of Law and Analysis**

50. A taxpayer seeking review of an assessing official's determination must make a prima facie case showing both that the current assessment is incorrect and what the correct assessment should 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). If the taxpayer makes a prima facie case, the burden shifts to the respondent to offer evidence to rebut or impeach the taxpayer's

evidence. *See American United Life Ins. Co. v. Maley*, 803 N.E.2d 276 (Ind. Tax Ct. 2004); *Meridian Towers*, 805 N.E.2d at 479. But the burden of proof remains with the taxpayer. *See Thorntown Tel. Co. v. State Bd. of Tax Comm'rs*, 629 N.E.2d 962, 965 (Ind. Tax Ct. 1995).

51. Indiana assesses property on the basis of its true tax value. For most real property, true tax value is defined 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 2 (incorporated by reference at 50 IAC 2.3-1-2 (2009)). There is no dispute, however, that the subject property is a Section 42 property. And Indiana Code Section 6-1.1-4-41 defines the true tax value of a Section 42 property as follows:

(a) For purposes of this section:

(1) "low income rental property" means real property used to provide low income housing eligible for federal income tax credits awarded under Section 42 of the Internal Revenue Code; and

(2) "rental period" means the period during which low income rental property is eligible for federal income tax credits awarded under Section 42 of the Internal Revenue Code.

(b) *For assessment dates after February 28, 2006, the true tax value of low income rental property is the greater of the true tax value:*

*(1) determined using the income capitalization approach; or*

*(2) that results in a gross annual tax liability equal to five percent (5%) of the total gross rent received from the rental of all units in the property for the most recent taxpayer fiscal year that ends before the assessment date. . . .*

Ind. Code § 6-1.1-4-41(emphasis added). In addition, “[t]he 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.” I.C. § 6-1.1-4-41.

52. The legislature has also directed the Department of Local Government Finance (“DLGF”) to promulgate rules for annually adjusting the value of real property between general reassessments. I.C. § 6-1.1-4-4.5. For the years at issue in these appeals, the

DLGF's rule provided that a property's valuation date was January 1 of the year preceding the assessment date. 50 IAC 21-3-3(b)(2009).

53. The parties met their respective burdens of production by offering valuation opinions from qualified expert witnesses. Although two of the witnesses at least examined other approaches to value, all three witnesses ultimately based their opinions on the income capitalization approach without directly including the low income housing tax credits that BBR received in exchange for agreeing to the Section 42 restrictions. While none of the witnesses offered calculations to show that their valuation opinions were greater than an amount that would result in a gross annual tax liability equaling 5% of the gross rent received by BBR for its most recent fiscal year ending before each assessment date, the evidence shows that is the case.<sup>7</sup>
54. The Board therefore must weigh the experts' opinions to determine the subject property's true tax value. Two of the appraisers—Allardt and Lady—gave valuation opinions that were fairly close to each other. Both, however, were significantly less than Hoffman's opinion:

<b>Appraiser</b>	<b>January 1, 2005</b>	<b>January 1, 2006</b>	<b>January 1, 2007</b>
Hoffman	\$2,360,000	\$2,510,000	\$2,590,000
Allardt	\$1,045,000	\$920,000	\$1,230,000
Lady	\$1,200,000	\$1,210,000	\$1,280,000

The gulf between the opinions largely stems from differences in how the appraisers: (1) accounted for collection and vacancy losses, (2) estimated operating expenses, and (3) determined capitalization rates.

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<sup>7</sup> For example, the subject property had gross income of \$302,163.66 in 2006 (the calendar year preceding the March 1, 2007 assessment date, which presumably coincides with BBR's fiscal year). *Pet'r Ex. 11 at 47*. Five percent of that amount is \$15,108.18. The 2007 pay 2008 tax rate was 3.139%. *Id.* Given that rate, an assessment of \$481,305.60 would result in tax liability of \$15,108.18 ( $\$15,108.18 \div .03139 = \$481,305.60$ ). That assessment amount is well below any of the appraisers' valuation opinions. The same is true for the other assessment years at issue.

55. Hoffman did little to support his estimate of vacancy and collection losses at 6% of the property's potential gross income other than to summarily assert that he consulted various sources and that vacancy rates tend to be less for Section 42 and Section 515 projects than for market-rate properties in the same area. To the extent that those assertions might carry any weight as a general matter, they do not do so here. Instead, the undisputed evidence shows that the subject property was charging market rent for most of its units, so it was competing with conventional apartments. But the subject property's income-level restrictions limited its tenant pool compared to those conventional apartments.
56. By contrast, because Allardt used the subject property's actual income he did not separately estimate vacancy and collection losses. It is not clear that Allardt did much to check the subject property's actual history of vacancies and concessions against the market, other than his testimony that he got the sense that the subject property was well managed. On the other hand, Allardt's effective gross income for 2008 was close to the figures used by Hoffman and Lady. And Allardt gave a fairly credible reason for the property's higher vacancy and collection losses during 2006-2007—the shrinking of the property's tenant pool due to low-income families being able to get credit to buy homes.
57. Lady, in a sense, split the difference between Allardt's and Hoffman's approaches. Lady based his estimate on a five-year average of the subject property's actual vacancy rate and the property's competitiveness in its submarket. Thus, unlike Hoffman, Lady gave effect to the subject property's actual history, and unlike Allardt, he at least attempted to test that history against the market, albeit in a fairly conclusory manner. The Board therefore finds Lady's estimate of the subject property's vacancy and collection losses (and therefore his estimate of effective gross income) to be the most reliable.
58. Turning to the experts' estimates of the subject property's operating expenses, Hoffman differed significantly from Allardt and Lady. Hoffman estimated total expenses of only \$123,046 or \$2,050 per unit, while Allardt estimated \$171,000 or \$2,850 per unit and

Lady estimated \$164,061 or \$2,734 per unit. The Board finds the estimates of Allardt and Lady more credible.

59. Like his estimate of vacancy and collection losses, Hoffman's operating expense estimate was highly conclusory. He claimed to have compared the subject property's actual expenses to the expenses for comparable properties, but he did not identify any of those comparable properties or give any information about their expenses. Instead, Hoffman appears to have largely disregarded the local market in favor of regionalized statistics from nationally published sources to estimate expenses that were far less than the subject property's actual expenses. His reason for doing so—to avoid having to depend on the accounting methods and honesty of property owners—rings a little hollow. Hoffman did not point to anything that would call into question the accounting methods or honesty of BBR or its management firm. Nor did Hoffman apparently even try to find comparable properties with honest managers who used standard accounting practices.
  
60. Even Hoffman's statistical sources, at least what little we have of them, are a mixed bag. BBR offered information from one of Hoffman's sources—an executive summary of the National Apartment Association's *2007 Survey of Operating Income and Expenses in Rental Apartment Properties*. In that survey, the operating expenses for Bloomington and Indianapolis garden properties, excluding taxes, were \$2,348 and \$2,375, respectively compared to the \$2,050 that Hoffman estimated for the subject property. And when asked on cross-examination, Hoffman could not readily explain how the survey supported his expense estimate. The Assessor sought to mitigate that problem in her post-hearing response by pointing out that Hoffman's expense estimate roughly mirrors the survey's reported expenses for all subsidized garden apartments, at least when those expenses are expressed as percentage of gross potential rent. But that is because the gross potential rent reported in the survey exceeds the subject property's gross potential rent by \$3,365 per unit. The Board does not mean to imply that calculating expenses as a percentage of potential gross rent is improper; indeed, the survey reports those percentages for a reason. But it makes doing so in this case less persuasive.

61. Unlike Hoffman, Allardt and Lady gave significant weight to the subject property's actual expenses while checking those expenses against market indicators. Allardt, in particular, looked at competitive properties from markets similar to Rushville. And Lady broke down his analyses item by item, giving a more detailed projection than the other two appraisers. The Board therefore finds Allardt and Lady's expenses analyses more persuasive than Hoffman's.
62. That leaves the experts' calculations of an appropriate capitalization rate. Again, Hoffman's opinion differs significantly from the rates determined by Allardt and Lady. And, as with his other analyses, Hoffman was largely conclusory in explaining how he chose his overall rate. At most, Hoffman attached a copy of a *Korpacz* national survey for all apartments and explained that, in his view, investing in subsidized apartments involves less risk than investing in conventional apartments, because subsidized properties tend to have lower vacancy rates and investors use the sale of tax credits, rather than their own money, as equity to develop and build subsidized properties.
63. Of course, both Allardt and Lady disputed Hoffman's view. And it is unclear whether Hoffman's approach complies with Ind. Code § 6-1.1-4-40's ban against considering the value of tax credits in determining a Section 42 property's true tax value. But the Board need not decide those questions today. Mr. Allardt persuasively testified about the limited tenant pool for Section 42 properties in Rushville, and the subject property had significant vacancy issues in 2006 and 2007. Thus, regardless of whether Section 42 properties have significantly less risk than conventional apartments as a general matter, the Board does not find that to have been true for the subject property.
64. Hoffman magnified the problems with his choice of an overall rate by loading that rate with a "tax additur factor" that reflected the subject property's abatement instead of using the property's effective tax rate without regard to the abatement. The abatement declines over a 10 year period. Indeed, the abatement's value decreased even more significantly with the advent of "tax caps" (credits under Ind. Code §§ 6-1.1-20.6-7 and -7.5 that are



applied against a taxpayer's property tax liability), although an investor on March 1, 2006, or March 1, 2007, arguably might not have anticipated those caps being enacted. In any case, as both Allardt and Lady explained, Hoffman's decision to factor the 2007 abatement into his capitalization rate distorted his valuation conclusions. Direct capitalization assumes the same income and expenses in perpetuity, or at least over the property's likely holding period. By factoring the abatement into his capitalization rate, Hoffman treated a temporary tax advantage that declined with each passing year as something that would significantly affect the property's anticipated income stream over the entire course of the holding period.

65. Unlike Hoffman, Allardt extracted an overall rate from the market, which he explained is the preferred method where there is sufficient data for sales of similar, competitive properties. Thus, Allardt's overall rate has the virtue of being closely tied to the subject property's market. On the other hand, the Assessor impeached Allardt to some degree with information that the seller in one of the transactions that Allardt relied most heavily on may not have been typically motivated. At the end of the day, however, that was only one sale and the rest of Allardt's data generally supported his choice of an overall rate. Also, Lady came up with overall rate that was close to Allardt's rate for 2006 and identical to his rates for 2007-2008, although Lady gave much less detail about how he arrived at his conclusions and he did not separately extract a rate from the market. Nonetheless the two appraisers' conclusions tend to support each other and are both more credible than Mr. Hoffman's conclusions.
66. Unlike Lady, however, Allardt did not ignore the subject property's abatement. Allardt instead determined the present value of the abatement from the perspective of each assessment year under appeal. Granted, that is less than ideal because the abatement's value depends on what the improvements are assessed for, and that is part of what is being litigated in these appeals. Nonetheless, the abatement likely would enter into an investor's calculus of how much he would be willing to pay for the subject property given its anticipated income stream and risk. Thus, while not perfect, Allardt's approach to the abatement is the most plausible of the three approaches taken by the appraisers.

67. To sum up, Lady and Allardt’s opinions are both more persuasive than Hoffman’s. Both Lady and Allardt were less conclusory than Hoffman. Unlike Hoffman, they did not largely ignore the subject property’s actual history and they more closely factored in local market conditions for Section 42 properties. And their capitalization rates did not carry the likelihood for distortion found in Hoffman’s treatment of the subject property’s abatement and his assignment of significantly reduced risk for the subject property as compared to conventional apartments. Indeed, Lady and Allardt’s opinions support each other in many ways. Of course, that begs the question: Which of those two opinions does the Board find more persuasive?
68. Of the two, Allardt gave more detailed support for his conclusions on the whole, both in his report and his testimony. And Allardt more closely followed USPAP’s guidance for giving a retrospective opinion of value. But Lady’s opinion was more persuasive than Allardt’s in two key respects: (1) Lady mitigated the subject property’s unusually high vacancy rates for 2006 and 2007 by taking average vacancy rates over five years and comparing those rates to the market, and (2) he analyzed the subject property’s expenses in more detail than did Allardt. Thus, with the exception of Lady’s failure to account for the subject property’s abatement, the Board finds his opinion more persuasive.
69. Ordinarily, the Board would hesitate to blend values from the testimony of different experts. But Lady acknowledged that, were he to account for the subject property’s abatement, Allardt’s method of doing so would be appropriate. Thus, on the unique facts of this case, the Board finds that the present value of the abatement should be added to Lady’s valuation opinion for each assessment year at issue, leaving the following true tax values:

<u>Assessment Date</u>	<u>Lady Appr.</u>	<u>Tax Abtmt.</u>	<u>True Tax Value</u>
March 1, 2006	\$1,200,000	\$43,226	\$1,243,226
March 1, 2007	\$1,210,000	\$24,061	\$1,234,061
March 1, 2008	\$1,280,000	\$8,833	\$1,288,833

## Summary of Final Determination

70. The preponderance of the evidence demonstrates that the subject property's assessments were wrong and that the subject property should be assessed for the following amounts: \$1,243,200 for March 1, 2006; \$1,234,100 for March 1, 2007; and \$1,288,800 for March 1, 2008.<sup>8</sup> The Board orders the assessments to be changed in accordance with these findings.

The Indiana Board of Tax Review issues this Final Determination of the above captioned matter on the date written above.

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Chairman, Indiana Board of Tax Review

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Commissioner, Indiana Board of Tax Review

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Commissioner, Indiana Board of Tax Review

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<sup>8</sup> The Board rounded the total assessment to the nearest \$100 increment. *See* 2002 REAL PROPERTY ASSESSMENT GUIDELINES, ch. 2 at 130 (incorporated by reference at 50 IAC 2.3-1-2)(instructing assessors to report assessed value "rounded to the nearest \$100").

## **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>>