STATE OF INDIANA
Board of Tax Review

MERIDIAN TOWERS EAST & WEST, Petitioner, v. MARION COUNTY PROPERTY TAX ASSESSMENT BOARD OF APPEALS and WASHINGTON TOWNSHIP ASSESSOR, Respondents.	)	On Appeal from the Marion County Board of Review Petition for Review of Assessment, Form 131 Petition Nos. 49-801-98-1-4-00007 49-801-98-1-4-00010 Parcel Nos. 8043278 8014618

Findings of Fact and Conclusions of Law

On January 1, 2002, pursuant to Public Law 198-2001, the Indiana Board of Tax Review (IBTR) assumed jurisdiction of all appeals then pending with the State Board of Tax Commissioners (SBTC), or the Appeals Division of the State Board of Tax Commissioners (Appeals Division). For convenience of reference, each entity (the IBTR, SBTC, and Appeals Division) is hereafter, without distinction, referred to as "State". The State having reviewed the facts and evidence, and having considered the issues, now finds and concludes the following:

Issue

Whether the improvements should receive additional obsolescence.

Findings of Fact

1. If appropriate, any finding of fact made herein shall also be considered a conclusion of law. Also if appropriate, any conclusion of law made herein shall also be considered a finding of fact.

2. Pursuant to Ind. Code § 6-1.1-15-3, Sandra K. Bickel, on behalf of Meridian Towers East & West, LLC (Petitioner), filed Form 131 petitions requesting a review by the State. The Marion County Property Tax Board of Appeals issued the Final Determination for Petition 49-801-98-1-4-00007 on October 11, 2000 and the Final Determination for Petition 49-801-98-1-4-00010 on September 22, 2000. The Form 131 Petition for both appeals was filed on October 19, 2000.

3. Pursuant to Ind. Code § 6-1.1-15-4, a hearing was held on June 29, 2001, before Hearing Officer Debra Eads. Testimony and exhibits were received into evidence. Sandra Bickel as attorney, Ted Herring, Property Manager for Revel & Underwood, LLC, and Douglas Rogers, appraiser, represented the Petitioner. A. Peter Amundson represented the Washington Township Assessor's Office. Although formal written notice was mailed to the Marion County Assessor's Office, no one appeared on its behalf.

4. At the hearing, the subject Form 131 Petitions were made a part of the record and labeled as Board's Exhibit A. The Notices of Hearing were labeled as Board's Exhibit B. In addition, the following items were submitted to the State:

Petitioner's Exhibit 1 – Seventeen (17) interior and exterior photographs of the subject property.
Petitioner's Exhibit 2 – Appraisal report dated December 9, 1999, prepared by D.S. Rogers & Associates, Inc.
Petitioner's Exhibit 3 – Subject property rent rolls dated December 2, 1997 and February 4, 1998.

Respondent's Exhibit 1 – A page of appraisal definitions from the International Association of Assessing Officers (IAAO).
Respondent's Exhibit 2 – A page from the Indianapolis Business Journal's 1998 Book of Lists.

Respondent's Exhibit 3 – Standards for the Application of Obsolescence used by Marion County Township Assessors.

5. Meridian Towers Apartments, consisting of two seven-story buildings, are located at 3965 N. Meridian Street and 25 E. 40th St., Indianapolis, Washington Township, Marion County.

6. The 1998 assessed values for parcel 8-014618 are:
Land: $22,770 Improvements: $551,270.
The 1998 assessed values for parcel 8-043278 are:
Land: $15,530 Improvements: $465,500.

7. The Hearing Officer did not conduct an on-site inspection of the subject property.

Whether the improvements should receive additional obsolescence.

8. The Petitioner and the Township agreed to the presence of obsolescence for both parcels. Disagreement exists between the parties as to the amount of obsolescence to be applied.

9. The Petitioner contended that the property experiences economic obsolescence due to external forces relative to over-building and subsequent excess availability of apartments in the area. The Petitioner further contended that functional obsolescence is present due to the out-dated nature of some components of the subject property as well as the fact that some components are inoperable. In an effort to quantify the obsolescence requested, a replacement cost was calculated, using the Marshall & Swift Valuation Service, and compared with value derived by using the Income Approach to value. Rogers Testimony. (Petitioner's Exhibit 2).

10. Upon questioning by the Hearing Officer, the Petitioner was unable to testify as to the sale price paid by the present owner when the subject property was

purchased in 1997. Ms. Bickel stated that parcels other than those under appeal were included in the sale and that the consensus of she, Mr. Herring, and Mr. Rogers was that the sale price was excessive.

11. Ms. Bickel stated that the Marion County guidelines for the application of obsolescence are arbitrary and do not consider economic rent loss.

Conclusions of Law

1. The Petitioner is limited to the issues raised on the Form 130 petition filed with the Property Tax Assessment Board of Appeals (PTABOA) or issues that are raised as a result of the PTABOA's action on the Form 130 petition. 50 IAC 17-5-3; Ind. Code §§ 6-1.1-15-1, -2.1, and –4. See also the Forms 130 and 131 petitions. In addition, Indiana courts have long recognized the principle of exhaustion of administrative remedies and have insisted that every designated administrative step of the review process be completed. *State v. Sproles,* 672 N.E. 2d 1353 (Ind. 1996); *County Board of Review of Assessments for Lake County v. Kranz* (1964), 224 Ind. 358, 66 N.E. 2d 896. Regarding the Form 130/131 process, the levels of review are clearly outlined by statute. First, the Form 130 petition is filed with the County and acted upon by the PTABOA. Ind. Code §§ 6-1.1-15-1 and –2.1. If the taxpayer, township assessor, or certain members of the PTABOA disagree with the PTABOA's decision on the Form 130, then a Form 131 petition may be filed with the State. Ind. Code § 6-1.1-15-3. Form 131 petitioners who raise new issues at the State level of appeal circumvent review of the issues by the PTABOA and, thus, do not follow the prescribed statutory scheme required by the statutes and case law. Once an appeal is filed with the State, however, the State has the discretion to address issues not raised on the Form 131 petition. *Joyce Sportswear Co. v. State Board of Tax Commissioners,* 684 N.E. 2d 1189, 1191 (Ind. Tax 1997). In this appeal, such discretion will not be exercised and the Petitioner is limited to the issues raised on the Form 131 petition filed with the State.

2. The State is the proper body to hear an appeal of the action of the County pursuant to Ind. Code § 6-1.1-15-3.

A. Indiana's Property Tax System

3. Indiana's real estate property tax system is a mass assessment system. Like all other mass assessment systems, issues of time and cost preclude the use of assessment-quality evidence in every case.

4. The true tax value assessed against the property is not exclusively or necessarily identical to fair market value. *State Board of Tax Commissioners v. Town of St. John,* 702 N.E. 2d 1034, 1038 (Ind. 1998)(*Town of St. John V)*.

5. The Property Taxation Clause of the Indiana Constitution, Ind. Const. Art. X, § 1 (a), requires the State to create a uniform, equal, and just system of assessment. The Clause does not create a personal, substantive right of uniformity and equality and does not require absolute and precise exactitude as to the uniformity and equality of each *individual* assessment. *Town of St. John V,* 702 N.E. 2d at 1039 – 40.

6. Individual taxpayers must have a reasonable opportunity to challenge their assessments. But the Property Taxation Clause does not mandate the consideration of whatever evidence of property wealth any given taxpayer deems relevant. *Id.* Rather, the proper inquiry in all tax appeals is "whether the system prescribed by statute and regulations was properly applied to individual assessments." *Id.* at 1040. Only evidence relevant to this inquiry is pertinent to the State's decision.

B. Burden

7. Ind. Code § 6-1.1-15-3 requires the State to review the actions of the PTABOA, but does not require the State to review the initial assessment or undertake

reassessment of the property. The State has the ability to decide the administrative appeal based upon the evidence presented and to limit its review to the issues the taxpayer presents. *Whitley Products, Inc. v. State Board of Tax Commissioners,* 704 N.E. 2d 1113, 1118 (Ind. Tax 1998) (citing *North Park Cinemas, Inc. v. State Board of Tax Commissioners,* 689 N.E. 2d 765, 769 (Ind. Tax 1997)).

8. In reviewing the actions of the PTABOA, the State is entitled to presume that its actions are correct. "Indeed, if administrative agencies were not entitled to presume that the actions of other administrative agencies were in accordance with Indiana law, there would be a wasteful duplication of effort in the work assigned to agencies." *Bell v. State Board of Tax Commissioners,* 651 N.E. 2d 816, 820 (Ind. Tax 1995). The taxpayer must overcome that presumption of correctness to prevail in the appeal.

9. It is a fundamental principle of administrative law that the burden of proof is on the person petitioning the agency for relief. 2 Charles H. Koch, Jr., *Administrative Law and Practice,* § 5.51; 73 C.J.S. Public Administrative Law and Procedure, § 128.

10. Taxpayers are expected to make factual presentations to the State regarding alleged errors in assessment. *Whitley*, 704 N.E. 2d at 1119. These presentations should both outline the alleged errors and support the allegations with evidence. "Allegations, unsupported by factual evidence, remain mere allegations." *Id* (citing *Herb v. State Board of Tax Commissioners,* 656 N.E. 2d. 890, 893 (Ind. Tax 1995)). The State is not required to give weight to evidence that is not probative of the errors the taxpayer alleges. *Whitley,* 704 N.E. 2d at 1119 (citing *Clark v. State Board of Tax Commissioners,* 694 N.E. 2d 1230, 1239, n. 13 (Ind. Tax 1998)).

11. The taxpayer's burden in the State's administrative proceedings is two-fold: (1) the taxpayer must identify properties that are similarly situated to the contested

property, and (2) the taxpayer must establish disparate treatment between the contested property and other similarly situated properties. In this way, the taxpayer properly frames the inquiry as to "whether the system prescribed by statute and regulations was properly applied to individual assessments." *Town of St. John V,* 702 N.E. 2d at 1040.

12. The taxpayer is required to meet his burden of proof at the State administrative level for two reasons. First, the State is an impartial adjudicator, and relieving the taxpayer of his burden of proof would place the State in the untenable position of making the taxpayer's case for him. Second, requiring the taxpayer to meet his burden in the administrative adjudication conserves resources.

13. To meet his burden, the taxpayer must present probative evidence in order to make a prima facie case. In order to establish a prima facie case, the taxpayer must introduce evidence "sufficient to establish a given fact and which if not contradicted will remain sufficient." *Clark,* 694 N.E. 2d at 1233; *GTE North, Inc. v. State Board of Tax Commissioners,* 634 N.E. 2d 882, 887 (Ind. Tax 1994).

14. In the event a taxpayer sustains his burden, the burden then shifts to the local taxing officials to rebut the taxpayer's evidence and justify its decision with substantial evidence. 2 Charles H. Koch, Jr. at §5.1; 73 C.J.S. at § 128. *See Whitley,* 704 N.E. 2d at 1119 (The substantial evidence requirement for a taxpayer challenging a State Board determination at the Tax Court level is not "triggered" if the taxpayer does not present any probative evidence concerning the error raised. Accordingly, the Tax Court will not reverse the State's final determination merely because the taxpayer demonstrates flaws in it).

C. Review of Assessments After *Town of St. John V*

15. Because true tax value is not necessarily identical to market value, any tax appeal that seeks a reduction in assessed value solely because the assessed

value assigned to the property does not equal the property's market value will fail.

16. Although the Courts have declared the cost tables and certain subjective elements of the State's regulations constitutionally infirm, the assessment and appeals process continue under the existing rules until a new property tax system is operative. *Town of St. John V,* 702 N.E. 2d at 1043; *Whitley,* 704 N.E. 2d at 1121.

17. *Town of St. John V* does not permit individuals to base individual claims about their individual properties on the equality and uniformity provisions of the Indiana Constitution. *Town of St. John*, 702 N.E. 2d at 1040.

D. Whether the improvements should receive additional obsolescence.

18. The PTABOA applied 10% obsolescence depreciation to the property. Meridian contended that the property has experienced both economic and functional obsolescence, and should receive 74% total obsolescence depreciation.

19. Depreciation is an essential element in the cost approach to valuing property. Depreciation is the loss in value from any cause except depletion, and includes physical depreciation and functional and external (economic) obsolescence.[1] *International Association of Assessing Officers (IAAO) Property Assessment Valuation*, 153 & 154 (2nd ed. 1996); *Canal Square Limited Partnership v. State Board of Tax Commissioners,* 694 N.E. 2d 801, 806 (Ind. Tax 1998) (citing *Am. Inst. Of Real Estate Appraisers, The Appraisal of Real Estate*, 321 (10th ed. 1992)). Depreciation is a concept in which an estimate must be predicated upon a comprehensive understanding of the nature, components, and theory of depreciation, as well as practical concepts for estimating the extent of it in improvements being valued. 50 IAC 2.2-10-7.

[1] Depletion is the loss in value of property due to consumption of oil, gas, precious metals, and timber.

20. Depreciation is a market value concept and the true measure of depreciation is the effect on marketability and sales price. *IAAO Property Assessment Valuation* at 153. The definition of obsolescence in the Regulation 50 IAC 2.2-10-7 is tied to the one applied by professional appraisers under the cost approach. *Canal Square,* 694 N.E. 2d at 806. Accordingly, depreciation can be documented by using recognized appraisal techniques. *Id.*

21. Economic obsolescence (or economic depreciation) is defined as "obsolescence caused by factors extraneous to the property." 50 IAC 2.2-1-24.

22. "Economic obsolescence may be caused by, but is not limited to, the following:
(A) Location of the building is inappropriate for the neighborhood.
(B) Inoperative or inadequate zoning ordinances or deed restrictions.
(C) Noncompliance with current building code requirements.
(D) Decreased market acceptability of the product for which the property was constructed or is currently used.
(E) Termination of the need of the property due to actual or probable changes in economic or social conditions.
(F) Hazards, such as danger from floods, toxic waste, or other special hazards."
50 IAC 2.2-10-7(e)(2).

23. Functional obsolescence depreciation is defined as "obsolescence caused by factors inherent in the property itself." 50 IAC 2.2-1-29.

24. "Functional obsolescence may be caused by, but is not limited to, the following:
(A) Limited use or excessive material and product handling costs caused by an irregular or inefficient floor plan.
(B) Inadequate or unsuited utility space.
(C) Excessive or deficient load capacity."
50 IAC 2.2-10-7(e)(1).

25. The elements of functional and economic obsolescence can be documented using recognized appraisal techniques. These standardized techniques enable a knowledgeable person to associate cause and effect to value pertaining to a specific property.

26. It is incumbent on the taxpayer to establish a link between the evidence and the loss of value due to obsolescence. After all, the taxpayer is the one who best knows his business and it is the taxpayer who seeks to have the assessed value of his property reduced. *Rotation Products Corp. v. Department of State Revenue,* 690 N.E. 2d 795, 798 (Ind. Tax 1998).

27. Regarding obsolescence, the taxpayer has a two-prong burden of proof: (1) the taxpayer has to prove that obsolescence exists, and (2) the taxpayer must quantify it. *Clark v. State Board of Tax Commissioners,* 694 N.E. 2d 1230, 1233 (Ind. Tax 1998).

28. The Township and the Petitioner agreed that obsolescence exists in the subject property. The first prong of the two-prong *Clark* test is therefore satisfied.

29. The Petitioner must also establish that the amount of obsolescence applied by the PTABOA was insufficient. There are five recognized methods used to measure obsolescence: (1) the sales comparison method, (2) the capitalization of income method, (3) the economic age-life method, (4) the modified economic age-life, and (5) the observed condition (breakdown) method. *IAAO Property Assessment Valuation*, 156 (2nd ed. 1996).

30. Mr. Rogers' appraisal purported to use both the cost approach (observed condition method) and the capitalization of income method to value the apartment buildings. Mr. Rogers then compared these two values and concluded the improvements have experienced 74% total obsolescence.

31. "The basic steps in the income approach are as follows:

1. Estimate potential gross income.
2. Deduct for vacancy and collection loss.
3. Add miscellaneous income to get effective gross income.
4. Determine operating expenses.
5. Deduct operating expenses from the effective gross income to determine net operating income before discount, recapture, and taxes.
6. Select the proper capitalization rate.
7. Determine the appropriate capitalization procedure to be used.
8. Capitalize the net operating income into an estimated property value." *Id*. at 204.

32. The appraisal prepared by Mr. Rogers identified seven purported comparable properties.

33. In determining whether properties are truly comparable, "Factors and trends that affect value, as well as the influences of supply and demand, should be considered. The greatest comparability is obtained when the properties being compared are influenced by the same economic trends and environmental (physical), economic, governmental, and social factors. There may not be any comparability when one property is heavily influenced by one set of factors and another property is significantly affected by dissimilar factors." *Id.* at 103.

34. Merely characterizing properties as comparable is insufficient for appeal purposes. The Petitioner is required to present probative evidence that the purported comparable properties it offers are, in fact, comparable to the subject property. No such foundation was presented in either the appraisal report or during testimony offered at the hearing. Mr. Rogers presented no explanation as to the manner in which properties ranging in unit size from 571 square feet to 2,516 square feet and with monthly rents ranging from $310 to $1,320 are comparable, either to each other or to the subject properties. Mr. Rogers offered

no comparison of common features or amenities among the properties, and no discussion of whether the purported comparable properties are all "influenced by the same economic trends and environmental (physical), economic, governmental, and social factors." *Id*.

35. Additionally, Mr. Rogers failed to explain why anyone would pay $1,320 per month in rent when a supposedly comparable unit could be rented for $310 per month.

36. Mr. Rogers' conclusory statements do not constitute probative evidence. *Whitley*, 704 N.E. 2d at 1119.

37. "The first step in the income approach to value is to estimate the potential gross income for the property in question. *Potential gross income* is annual economic rent for the property at 100 percent occupancy. *Economic rent* is the annual rent that is justified for the property on the basis of a careful study of comparable properties in the area." *IAAO Property Assessment Valuation*, 204 (2nd ed. 1996).

38. Mr. Rogers' appraisal contended that the economic rent for the property under appeal is $.70 per square foot. As discussed, however, Mr. Rogers has failed to identify comparable properties to establish a foundation for this amount, as required by generally accepted standards of assessment and appraisal practice.

39. Indeed, rather than identifying comparable properties and then determining economic rents, Mr. Rogers reversed the process. "We would expect that the subject ought to compare near the middle of the probable value range for rentals…the median level of effective rents…[is] 52 cents/sf/month." (Petitioner's Exhibit 2, page 14).

40. Mr. Rogers therefore started with an assumption as to the economic rents and then selected apartments that conformed with his assumption that the property under appeal is in the "middle of the probable value range."

41. "The vacancy factor for any particular property must be determined by a study of other comparable properties and an analysis of their rental histories, as well as the recent history of vacancies in the subject property." *IAAO Property Assessment Valuation*, 211 (2nd ed. 1996).

42. Mr. Rogers' calculations contain no vacancy factor "determined by a study of other comparable properties and an analysis of their rental histories", as required by generally accepted standards of assessment and appraisal practice.

43. The net operating income is determined by deducting operating expenses from the effective gross income. "Determining *operating expenses* requires a thorough analysis of typical expenses by property use type to determine proper and improper expenses." *Id.* at 227.

44. Mr. Rogers' appraisal contains an operating expense ratio of 73%. However, this is based on the actual expenses incurred by Meridian rather than a "thorough analysis of typical expenses" as required by generally accepted standards of assessment and appraisal practice.

45. Mr. Rogers contended that the "average OER [operating expense ratio] reported for the Admiral and Drake buildings between 1995 and 1998 inclusive was 56%, varying little each year. We take this as the best evidence of an economic OER." (Petitioner's Exhibit 2, page 15).

46. Mr. Rogers failed to explain the reason why, of the seven purported comparable properties he presented, he included only two in his calculation of an OER. Further, as discussed, Mr. Rogers failed to establish that any of his purported comparable properties are, in fact, comparable to the property under appeal.

47. Consequently, Mr. Rogers' proposed net operating income (NOI) has no basis.

48. Mr. Rogers' appraisal then subtracts 10% "return to land" from the NOI. As discussed, this is not one of the basic steps in the income approach. Indeed, "The direct relationship between net operating income and…value can be expressed by an overall [capitalization] rate. This rate includes a provision for discount as well as recapture, **even though land and building values are not separated**." *Id.* at 243 (emphasis added). Additionally, Mr. Rogers offered no explanation for his choice of 10% as the amount to "return to land".

49. The appraisal identifies potential overall capitalization rates ranging from 8.9% to 14.5% in the narrative. Mr. Rogers applied an overall capitalization rate of 12% to the subject property. However, no foundation was presented to support this selected rate.

50. "Acceptable methods for developing the overall capitalization rate include derivation from the following:

    1. comparable sales
    2. gross income multipliers (net income ratio method)
    3. band-of-investment method – using land and building components
    4. band-of-investment method – using mortgage and equity techniques
    5. debt coverage formula" *Id*.

51. Mr. Rogers presented no evidence that he employed any of these methods to calculate an overall capitalization rate.

52. Mr. Rogers asserted, "The Appraisal Institute publication *Market Source* [4th Quarter 1999] quotes Indianapolis area apartment cap rates at an average of 8.9%. We suspect most of the these are for suburban garden apartments with better demand and cash flow." Mr. Rogers then rejected this published capitalization rate.

53. Instead, Mr. Rogers opined that "the obsolescence in the subject and the existence of overbuilt high-rise apartment space and several negative influences in the neighborhood make the investment more speculative than average. We conclude that an OAR [overall capitalization rate] of 12% should apply to the subject." (Petitioner's Exhibit 2, page 16).

54. Mr. Rogers' suspicions and unsubstantiated conclusions do not constitute probative evidence. *Whitley*, 704 N.E. 2d at 1119.

55. Indeed, Mr. Rogers has presented nothing but a circular argument: he assumes a high level of obsolescence is present to justify the capitalization rate, and then uses a high capitalization rate to support his claim that the buildings suffer from a high level of obsolescence.

56. Mr. Rogers has therefore offered no foundation for his choice of a 12% overall capitalization rate. "The understanding and proper selection of rates used in the income approach are necessary if valid estimates of value are to be made. A small difference in the capitalization rate will result in estimates differing by thousands of dollars." *IAAO Property Assessment Valuation*, 233 (2nd ed. 1996).

57. The State is under no obligation to give, and does not give, Mr. Rogers' Income Approach calculation any weight.

58. Mr. Rogers also presented a Cost Approach method of valuing the property. Mr. Rogers asserted that this cost approach was based on values published by Marshall Valuation Service.

59. Mr. Rogers initially contended that the buildings were "valued as an (sic) Good Quality Class B High-Rise Apartment." (Petitioner's Exhibit 2, page 10). The calculations, however, indicate that the buildings were actually valued as Average, rather than Good, quality structures. *Id.* at 11 and 12.

60. Mr. Rogers then compared the results from his Income Approach calculation to results obtained from a Cost Approach analysis. Mr. Rogers contended that the difference between these two amounts represented obsolescence.

61. As discussed in detail, Mr. Rogers' Income Approach analysis is severely flawed. Any subsequent obsolescence calculation employing this flawed component must, therefore, also be flawed.

62. Meridian has therefore failed to quantify any amount of claimed obsolescence depreciation, as required by the second prong of the two-prong test articulated in *Clark*.

63. For all the reasons above, the Petitioner failed to meet its burden in this appeal. Accordingly, no change is made to the assessment as a result of this issue.

The above stated findings and conclusions are issued in conjunction with, and serve as the basis for, the Final Determination in the above captioned matter, both issued by the Indiana Board of Tax Review this ____ day of_____, 2002.

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Chairman, Indiana Board of Tax Review