STATE OF INDIANA
Board of Tax Review

Pedcor Investments-1996-XXV, L.P.,	)	On Appeal from the Jackson County
	)	Property Tax Assessment Board
Petitioner,	)	of Appeals
	)	
v.	)	Petition for Review of Assessment, Form 131
	)	Petition No. 36-008-98-1-4-00001
JACKSON COUNTY PROPERTY TAX	)	Parcel No. 06-06-2200-00502
ASSESSMENT BOARD OF APPEALS	)	
and JACKSON TOWNSHIP	)	
ASSESSOR	)	
	)	
Respondents.	)	

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

1. Whether economic obsolescence is warranted due to restrictions limiting rents and income levels of residents.

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, Phillip J. Stoffregen, Executive Vice President of Pedcor Investments, LLC (Pedcor)[1], filed a Form 131 petition requesting a review by the State. The Jackson County Property Tax Assessment Board of Appeals final determination on the underlying Form 130 petition is dated December 11, 2000. The Form 131 petition was filed on January 19, 2001.

3. Pursuant to Ind. Code § 6-1.1-15-4, a hearing was held on September 27, 2001, before Hearing Officer Debra Eads. Testimony and exhibits were received into evidence. Maureen Hougland, Vice President of Pedcor, and Bonnie Mitchell, appraiser, represented the Petitioner. Patricia Cummings represented the Jackson Township Assessor's Office. No one was present to represent the Jackson County Assessor's Office.

4. At the hearing, the subject Form 131 petition was made a part of the record and labeled Board's Exhibit A. The Notice of Hearing on Petition was labeled Board's Exhibit B. In addition, the following exhibits were submitted as evidence:

   Petitioner's Exhibit 1 – Brief in support of the Petitioner's contentions.
   Petitioner's Exhibit 2 – Certification of the brief by Phillip J. Stoffregen.
   Petitioner's Exhibit 3 – Median income information for 1998.
   Petitioner's Exhibit 4 – Appraisal of subject property dated December 13, 1995.

   Respondent's Exhibit 1 – Memorandum stating the respondent's position.

[1] Several Pedcor business entities have been involved in the property under appeal. The distinction between these entities has no bearing in this appeal. For convenience, therefore, all will be referred to as Pedcor.

5. The subject property is an apartment complex located on U.S. Highway 31 North in Seymour, Indiana (Jackson Township, Jackson County).

6. The Hearing Officer did not view the subject property.

Whether economic obsolescence is warranted due to restrictions limiting rents and income levels of residents.

7. The PTABOA did not grant any economic obsolescence to the property. The Petitioner contended that the apartment complex should receive "12.99%-30.39% economic obsolescence as a percentage of fair market value."

8. The subject property participates in the Low Income Housing Tax Credit (LIHTC) program defined in §42 of the Internal Revenue Service Code. In Indiana, this program is administered by the Indiana Housing Finance Authority (IHFA).

9. Under the terms of this program, the subject will receive tax credits for 10 years in exchange for renting apartments to individuals whose income is at or below 60% of the median income for the county.

10. All apartments are subject to the LIHTC program agreement. The Petitioner voluntarily chose to enter into the LIHTC program.

11. In 1998, the median income in Jackson County was $41,800; the maximum income allowed for a family of four would be $36,100. (Petitioner's Exhibit 3).

12. Pedcor Investments, LLC is the general partner. They were responsible for the development and management of the subject property. The limited partners are the "money men." The limited partners provided cash, in return for the tax credits, to allow Pedcor to secure the mortgage to construct the subject. These tax credits are a dollar for dollar credit against federal income tax. The tax credits are generally sold to institutional investors, and in this case, the Petitioner

presented an appraisal of the subject done for mortgage purposes that indicated the tax credits would be sold for $0.61 each. Petitioner Exhibit 4, page 110. However, in Petitioner's Exhibit 1, tab 12 there evidence that the Petitioner sold the tax credits for $0.78 each. For the purposes of this appeal, the $0.78 is assumed to be the price, however, the Petitioner does not present any evidence to substantiate either amount.

13. Pedcor will receive $2,458,280 in tax credits over a 10-year period, under the terms of its "Declaration of Extended Low-Income Housing Commitment," dated December 30, 1997. (Petitioner's Exhibit 1, tab 4). Pedcor first received the benefit of the tax credits in 1997 and will continue to receive tax credits each year through 2008, assuming it is in compliance with Section 42 of Internal Revenue Code.[2]

14. The Petitioner contends that it is entitled to an obsolescence adjustment because the rent restrictions, as required as a condition of eligibility for the LIHTC program, result in a loss of value.

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

[2] 1997 and 1998 were partial years as will 2007 and 2008 be to make up for this difference.

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, neither party requested that such discretion 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 even though 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 V*, 702 N.E. 2d at 1040.

D. Whether economic obsolescence is warranted due to restrictions limiting rents and income levels of residents.

1. Definitions and Burden

18. The subject property is not currently receiving an obsolescence depreciation adjustment. The Petitioner claimed economic obsolescence in a range of 12.99% - 30.39% is present in the property.

19. Depreciation is an essential element in the cost approach to valuing property. Depreciation is the loss in value from any cause except depletion,[3] and includes physical depreciation and functional and external (economic) obsolescence. 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.

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 directly to that 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 depreciation is defined as “obsolescence caused by factors extraneous to the property.” 50 IAC 2.2-1-24.

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

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. The elements of 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.

24. 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).

25. Regarding obsolescence, the taxpayer has a two-prong burden of proof: (1) the taxpayer has to prove the 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).

Causes of Obsolescence

26. "[I]n advocating for an obsolescence adjustment, a taxpayer must first provide the State Board with probative evidence sufficient to establish a prima facie case

as to the causes of obsolescence." *Champlin Realty Company v. State Board of Tax Commissioners,* 745 N.E. 2d 928, 932 (Ind. Tax 2001).

27. The identification of causes of obsolescence requires more than randomly naming factors. "Rather, the taxpayer must explain how the purported causes of obsolescence cause the subject improvements to suffer losses in value." *Champlin,* 745 N.E. 2d at 936.

28. The Petitioner claimed that obsolescence is inherent in the property because it participates in the LIHTC program which imposes deed restrictions on the property that result in a loss of rental income. Petitioner further argues that the loss of value arising from the rent restrictions is greater than the enhancement in value derived from the LIHTC program benefits, thereby meeting the test laid out in *Pedcor Investments-1990-XIII, L.P. v. State Board of Tax Commissioners*, 715 N.E. 2d 432, 438 (Ind. Tax 1999) ("*Pedcor*").

29. Deed restrictions may be considered an external factor causing obsolescence because the pertinent factor "is not the deed restrictions *per se* but rather the marketplace's reaction to them. As times change, a deed restriction that at one time enhanced the value of a particular property may make that property less valuable as a result of changing *external* circumstances." *Pedcor* at 437. Therefore, Petitioner must establish that the market's reaction to the deed restrictions has changed due to external circumstances.

30. In addition, *Pedcor* holds that the State may take into consideration what if any benefits the Petitioner gained in exchange for the deed restrictions in its evaluation of obsolescence. Then, as now, the Petitioner entered into these deed restrictions in exchange for valuable federal tax credits. *See Pedcor* at 437. Petitioner must demonstrate that the market's reaction to this exchange – i.e. the combined effect of the deed restrictions (i.e. the loss of rental income) and the benefits of the Low Income Housing Tax Credits – has changed.

31. The Petitioner voluntarily signed the Declaration of Extended Low Income Housing Commitment (Declaration) (Petitioner's Ex. 1, tab 4) in return for tax credits. These tax credits were in turn used to attract investments from the limited partners. Participation in the LIHTC program was therefore an agreement among the general partner, the limited partners and the IHFA. In fact, it was the Petitioner who sought out these agreements with the IHFA and the limited partners.

32. Additionally, the appraisal done prior to construction for mortgage purposes stated the following: "The cost to acquire the site and develop the proposed improvements exceeds the value at stabilized occupancy. However, participation in the Low Income Housing Tax Credit Program provides other benefits to investors or developers that is not reflected in the value conclusions at market rents." Petitioner's Exhibit 4, p. 48.

33. The mere fact that Petitioner entered into the deed restrictions voluntarily does not preclude Petitioner from ever receiving obsolescence. *See Pedcor* at 437. However, on the facts before us, it is clear that Pedcor was well aware of the restrictions placed upon it by entering into the LIHTC program and equally aware of the benefits to be gained. Petitioner has entered into many similar transactions throughout the country. *See Petitioner's Exhibit 1(14)-- Certificate of Phillip Stoffregen*. Therefore, at the time Petitioner entered into the transaction, it understood (or should have understood) that the rents they received for the next thirty years would be below market rate. Petitioner weighed that burden against the $2.46 million of tax benefits gained over the following ten-year period and went forward. This is a compelling indication that Pedcor believed the tax credits were sufficient compensation for the rent reductions to make the transaction more attractive than a conventionally financed market-based housing project.

34. In spite of the logic that supports that Petitioner's decision to enter into the Declaration and develop the project, Petitioner, in seeking obsolescence, now argues that the combined effect of deed restrictions and tax credits create an

economic loss. Petitioner has submitted financial information, rent projections, rental market information and valuations of the LIHTC into evidence that, taken together, purport to show that the burden of the lost rents outweighs the benefits of the tax credits. See Petitioner's Exhibit 1 (8-13). However, Petitioner's burden is to demonstrate that a change in the market reaction occurred to the deed restrictions and/or the tax credits between the signing of the Declaration and the assessment date. That they have failed to do. For example, Petitioner did not demonstrate that the market rate for comparable housing had changed significantly, that the restrictions on the contract rents had changed or deviated from their reasonable projections, or that the overall value of LIHTC had been reduced.[4] The Petitioner has failed to show any negative market reaction to the bargain it originally struck.

35. Furthermore, Petitioner was, or should have been, able to balance the long-term benefit of the tax credits and long- term burden of rent restrictions. Certainly Petitioner was capable of making those projections and gathering that market information; the evidence offered at the hearing proves their understanding of the relevant market factors. When they looked at those factors in December 1997, they decided to proceed with a low-income housing project rather than a property that would rent at market rates. They have not met their burden to prove how those factors have changed to their disadvantage for the 1998 assessment.[5] Having failed to demonstrate any factors that changed in the market reaction to the LIHTC program, Pedcor has failed to demonstrate any loss in the value of the property as a result of deed restrictions. "Without a loss of value, there can be no economic obsolescence." *Pedcor* at 438.

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[4] Of course, the amount of tax credit available is reduced each year as this asset is transferred to the party who bargained for it. But there was no argument made that anticipated value, i.e. approximately $250,000 of tax credits per year has changed either through a change in the market value of these credits or through Petitioner's loss of eligibility for the Program.

[5] Even assuming that Petitioner made an imprudent business decision at the time of entering into the Declaration, an imprudent decision is not sufficient reason to reduce a taxpayer's assessed property value. *See Pedcor at 437, citing Lake County Trust No. 1163 v. State Bd. Of Tax Commissioners,* 694 N.E.2d 1253, 1258-9 (Ind. Tax).

36. The Petitioner has failed to demonstrate that participation in the LIHTC program created a loss in value to the property. The Petitioner therefore did not meet the first prong of the two-prong test articulated in *Clark.*

Quantification of Obsolescence

37. Even if the State accepted the existence of obsolescence, the Petitioner must still quantify the amount of obsolescence requested.

38. "There are two methods of measuring external [economic] obsolescence: (1) capitalizing the income or rent loss attributable to the negative influence; and (2) comparing comparable sales of similar properties, some exposed to the negative influence and others not." *IAAO Property Assessment Valuation*, 173 (2nd ed. 1996).

39. "The capitalization of income method: capitalizes the income of subject property into an estimate of value, with site value deducted; indicated improvement value is compared with estimated cost new to provide indication of improvement value remaining." *Id.* at 183.

40. "The sales comparison method: estimates cost new of subject property; comparable properties are found and site values deducted; contributory improvement values remain; contributory improvement values are deducted from cost for each sale property, yielding measure of accrued depreciation; accrued depreciation figure is converted to percentage and applied to subject property." *Id*.

Application of the Income Capitalization Method

41. The Petitioner attempted to quantify its claim for obsolescence using the following methodology:

(a) Petitioner calculated the difference in rent between rent-restricted units and market units and, after adjusting for vacancy and management expenses, claimed this difference in rental income was a dollar amount of economic obsolescence. (Petitioner's Exhibit 1, tab 12).

(b) Petitioner next computed a proposed fair market value of the property by adding the 1998 audited income (adjusted for reserves) to the difference in rental income to obtain an "adjusted 'market rate' NOI [net operating income]."

(c) The adjusted market rate NOI was then multipled by a capitalization rate of 9.00% to obtain a purported fair market value.

(d) The proposed dollar amount of economic obsolescence was then divided by the purported fair market value to determine a percentage of obsolescence.

42. Although Petitioner characterizes the above analysis as an income capitalization approach, it does not follow the methodology required under IAAO standards. The IAAO approach follows these basic steps:

1. Estimate potential gross income.
2. Deduct for vacancy and collection loss.
3. Add miscellaneous income to get the effective gross income.
4. Determine operating expense.
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."

IAAO Property Assessment Valuation at 204.

42. Petitioner includes in their income capitalization approach the step of dividing a reduced rental income by the fair market value of a property. This hybrid approach is not a generally accepted method of computing economic obsolescence. [6]

43. The Petitioner also presented an appraisal that conducted an income approach to valuing the subject property. This appraisal was done prior to construction and for mortgage/financing purposes. As a result, the appraisal is not as reliable as one done for property tax purposes after the building is constructed and operating.

44. The appraisal did use the income approach to arrive at market value for the subject. According to the appraisal, the value via the capitalization approach, at stabilized occupancy and market rents is $5,400,000. (Petitioner's Exhibit 4, p. 109). According to the appraisal, the value via the capitalization approach, at stabilized occupancy and restricted rents is $5,200,000. (Petitioner's Exhibit 4, p. 109).

45. At first glance, this would seem to support the Petitioner's position that there is a loss of value because of the restricted rents. However, the value at restricted rents did not include the value of the tax credits received by the apartment. The appraisal values the subject "At stabilized occupancy with restricted rents including value of the tax credits" as $6,640,000. (Petitioner's Exhibit 4, p. 4).

46. This value would be further increased depending on the value placed on the tax credits. The appraisal values the tax credits at $0.61 per $1.00 credit. The Petitioner, in its calculation values the tax credits at $0.78 per $1.00 credit.

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[6] Petitioner also fails to follow the first step in the income approach, i.e. to estimate the potential gross income for the property in question. Because it appears that this information can be derived from the materials with relative ease, it is unclear why Petitioner omitted this step. Nevertheless, the State is not required to perform this calculation on behalf of Petitioner. *See Canal Realty v. SBTC* 744 N.E.2d 597,602 (Ind. Tax Ct. 2001).

47. The True Tax Value of the subject, including land, as determined by the local officials, is $3,277,500. The market value arrived at by the appraisal, submitted by the Petitioner is nearly two (2) times that amount, when considering the value of the tax credits ($6,640,000). If anything, this appraisal may suggest that the subject property is undervalued.

Need for Comparable Properties

48. The Petitioner failed to identify any comparable properties to determine either the potential gross income or the economic rent of the market units, as required by generally accepted standards of assessment and appraisal practice.

49. "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." *Id* at 211.

50. The Petitioner's calculation is based on vacancy and collection losses actually experienced by the property under appeal, rather than those determined by a study of comparable properties, as required by generally accepted standards of assessment and appraisal practice. In other words, Petitioner is asking the State to use the non-rent restricted units of the subject property as a comparable property to the rent-restricted units of the same property.

51. Generally accepted assessment and appraisal standards require that the subject property be compared to something other than itself. Although it may appear an attractive alternative to standard appraisal methodology to adopt Petitioner's "internal comparability" approach, we must reject it. Choosing to follow the generally accepted appraisal and assessment standards in the instant case is far from an arbitrary or overly technical decision. A building that rents to the general public at market rates is a different property than one that rents all or a significant portion of its units in a rent-subsidized market. These differences may affect the

income capitalization approach at many of the required analytical steps: For example:

> (a) The implications for vacancy figures are very different. A below-market property will be easier to fully let than the same property at higher rents. If none of a property's units are available for rent at market rates (as is the case with the subject property), it may be much easier to achieve full occupancy than if it were a fully market rate apartment complex.
>
> (b) A market rent property will have different expense items. Marketing costs may be much higher as it seeks to attract tenants who have more housing options. More amenities may be required to compete for such tenants and there may be greater fluctuations in occupancy rates, collections and rents.
>
> (c) The capitalization rate will be affected by the level of risk of the investment. Participation in the LIHTC program has a significant impact on the risk analysis and on the return on the initial investment of the partners.

Of course, as Petitioner argues, the fact that much of the property is rented at below market rates may mean that the property is less attractive to traditional tenants or that the operating expenses for the subject property are higher due to the reporting requirements imposed by the LIHTC program. However, it is Petitioner's burden to present the comparative income and expense data to support those arguments. They have not done so.

52. The audited financial statements provided by Petitioner (see Petitioner's Exhibit 1, tab 9) appear to be prepared for income tax purposes or, in any event, were not prepared expressly for Petitioner's income capitalization analysis. " [A]ll of the income and expenses shown by an accountant on an operating statement

prepared for income tax purposes cannot be used in the income approach to value without careful analysis." *Id.* at 214. This distinction is not merely a technical one. Certain items are appropriate for inclusion as expenses for income tax purposes that are not appropriate for calculating NOI for property assessment and appraisal purposes. (See further discussion in paragraph 55, below).

53. Furthermore, without income and expense statements from comparable properties, there is no reasonable way to determine, assuming that a decline in value exists, that the decreased value is a result of truly external factors rather than poor management decisions. "In analyzing the operating expenses for a property, the operating statements from comparable properties must be reviewed…" *Id.* at 215.

<u>Selection of the Capitalization Rate</u>

54. Petitioner has provided no explanation for the selection of the capitalization rate, other than to put forth the conclusory statement that such a rate is "standard for the industry." 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." *Id.* at 233.

55. To the extent there is evidence relevant to the capitalization rate in the record, that evidence tends to support the application of a low capitalization rate. For example, at the hearing there was testimony of bond financing by the city, and the appraisal used a lower capitalization rate because of that. Also, Petitioner has included property taxes in the NOI calculation (See Petitioner's Exhibit 1, tab 9). Because those tax figures are a very significant expense item, this may have

a significant effect on the selection of the capitalization rate.[7] Again, removing the effective tax rate component from the calculation of the capitalization rate would ordinarily result in a lower overall cap rate. The State does not mean to suggest that the proposed capitalization rate is or should be lower than the proposed rate, merely that Petitioner has failed to present an adequate explanation for selecting this rate. Without an explanation or justification of this crucial factor, Petitioner's income analysis and ultimately the calculation of economic obsolescence is not supportable.

56. In fact, the appraisal submitted by the Petitioner used two separate capitalization rates. First, the appraisal used sales of comparable properties to arrive at a capitalization rate for the subject at market rents. (Petitioner's Exhibit 4, p. 108). The appraisal determines that the capitalization rate for the property, at market rents would be between 9.0% and 9.5%. The Appraisal uses a value between the two to arrive at a value. (Petitioner's Exhibit 4, p. 109).

57. In addition, the appraisal uses a different capitalization rate to value the property at restricted rents. The appraisal states: "The most logical method of developing the appropriate overall rate for the subject is by a simple band of investment technique. This method gives consideration to the below market interest rate available to the subject." The appraisal concludes that based upon this analysis, a capitalization rate of 7.25% is appropriate for the subject.

58. The State recognizes that these capitalization rates were determined prior to construction. However, the Petitioner makes no attempt to support the 9.0% used in their calculation in any manner. That is not to imply that the 9.0% is incorrect, just that there is not enough evidence in the record to adequately support the rate used. For instance, there was no evidence presented indicating

[7] See p. 4 of tab 9 in Petitioner's Exhibit 1. On the 1998 statement of income and loss, Petitioner lists Property taxes. Generally, property taxes are omitted from the expense statements when the valuation for property tax purposes is at issue and that expense item is dealt with as a component of the cap rate.

the 9.0% used by the Petitioner was arrived at through comparable sales, or band of investment technique, or some other method.

59. The Petitioner's unsubstantiated conclusions concerning the capitalization rate do not constitute probative evidence. *Whitley*, 704 N.E. 2d at 1119

Balancing the Tax Incentives against the Rent Reductions

60. Taxpayers receiving incentives for participating in low-income housing programs must also establish that these incentives do not make up for any loss in rental income incurred as a result of program restrictions. *Pedcor*, at 437.

61. Pedcor argues that the loss of rental income is greater than the value of the tax credits. To support its argument, Pedcor provided a calculation in which the value of the remaining tax credits was subtracted from the present value of the rent loss. This balance equaled the difference in rental income between restricted and market units, previously discussed.

62. The process Pedcor uses to quantify the difference between the cost of the rent restrictions and the benefit of the tax credit also raises many unanswered questions. Pedcor appears to be projecting the potential long-term impact of the rent restrictions, rather than any current loss of value. Based on Pedcor's own calculations, the value of the tax credit for the year in question is greater than the loss of rents. "Without a loss of value, there can be no economic obsolescence." *Pedcor at 438*.

63. Even assuming that Petitioner's projections over the thirty year life of the rent restrictions are a suitable and a reasonably accurate measure of Pedcor's economic loss, we question the accuracy of Petitioner's measurement of the value of the income tax credits.

64. In weighing the loss of rents (discounted for present value) against the value of the tax credits, Petitioner does not include the value of all the tax credits issued. Because the entire value of the tax credits was, or should have been, considered at the time Petitioner decided to move forward with low-income rather than market rate housing, the entire sequence of tax credits (and corresponding rental losses) should be considered in the evaluation of obsolescence. Because the value of the tax credits is compressed into a ten-year period, in contrast to the thirty-year term of restricted rents, Petitioner's equation undervalues the tax benefits compared to the rental losses.

65. Therefore, we do not find Petitioner's method of quantifying the relative value of the tax credits against the rental losses – the underpinning of Petitioner's economic obsolescence argument-- reliable.

66. The Petitioner therefore did not meet the second prong of the two-prong test articulated in *Clark.*

67. For all reasons set forth above, the Petitioner did not meet its burden of proof in this appeal. Accordingly, no change is made in 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