

**STATE OF INDIANA
Board of Tax Review**

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| ROCKVILLE ELDERLY HOUSING, LP, |) | On Appeal from the Parke County |
| |) | Property Tax Assessment Board |
| Petitioner, |) | of Appeals |
| |) | |
| v. |) | Petition for Review of Assessment |
| |) | Form 131 |
| PARKE COUNTY PROPERTY TAX |) | Petition No. 61-002-00-1-4-00002 |
| ASSESSMENT BOARD OF APPEALS |) | Parcel No. 0020008003 |
| and ADAMS 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:

Issues

The local officials applied a C grade to these apartments and did not grant any obsolescence for them. Initially, Rockville Elderly Housing (Rockville or Petitioner) sought the application of 35% obsolescence and a grade reduction from C to C-2. Later, Rockville modified its request to a total reduction of 30% in assessment, possibly by way of a 10% grade reduction and the grant of 20% obsolescence.

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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 be considered a finding of fact.

2. The property under review is a 36-unit apartment complex that is participating in a program that differs slightly from the standard USDA Rural Housing Service, Section 515 project. Petitioner's Ex. 4. The complex is located at 101 Pines Drive, Rockville, Indiana (Adams Township, Parke County).

3. Information provided from the USDA Rural Development Programs website (Petitioner's Exs. 1 and 2) reveals that this program is designed to provide housing to individuals living in rural areas. Tenancy is available to very low, low, and moderate income families, and to the elderly and persons with disabilities. Income limitations are identified in the web cites but, because Rockville's program differs slightly from the standard 515 project, Rockville's income limitation is different. *Petitioner's Ex. 4*. Generally Rockville's income limit for *new* tenants is below 60% of the median income for Parke County. *Id.*

4. Requirements for eligibility under the program that Rockville operates under include: For-profit borrowers of money agree to operate on a limited profit basis, currently 8% on initial investment. Typically, these apartment projects are 90% financed and the borrower provides 10% equity. A mortgage for the property is at "street rates" but the government subsidizes it down to a 1% mortgage. The government allows the borrower the recovery of allowable expenses, a modest profit, and reserve fund money for depreciating assets. *Campbell Testimony*.

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

The State does not know whether all requirements and facets of the program were provided to it.

5. The local officials did not grant obsolescence on this property. As a result, Rockville filed a Form 130 petition seeking 35% obsolescence due to the federally subsidized nature of the complex. *Board Ex. A*. Also, Rockville sought a grade reduction from C to C-2. *Id.*
6. The Parke County Property Tax Assessment Board of Appeals (PTABOA) denied the Form 130 petition. Pursuant to Ind. Code § 6-1.1-15-3, Ralph Campbell of Property Valuation Services, Inc. filed a Form 131 petition on behalf of Rockville. The Form 131 petition sought a review by the State and was filed on July 28, 2000.
7. Pursuant to Ind. Code § 6-1.1-15-4, a hearing was held on January 25, 2001 before Hearing Officer Joan Rennick. Testimony and exhibits were received into evidence. Mr. Ralph Campbell represented the Petitioner. Ms. Marilyn Allen represented the PTABOA. Ms. Sue Ann Woody observed the hearing as a representative of the PTABOA.
8. At the hearing, the subject 131 petition was made a part of the record and labeled Board Exhibit A. The Notice of Hearing on the Petition was labeled Board Exhibit B. The Hearing Sign In Sheet was labeled Board Exhibit C. In addition, the following items were submitted to the State:
Petitioner's Exhibit – 1 – USDA information re: Section 515 projects.
Petitioner's Exhibit – 2 – USDA fact sheet, 2 page Income Approach to Value analysis, 1998 & 1999 Federal Income Tax Returns, 50 IAC 2.2-11, Schedule C, Marshall Valuation Service 10/98-Segregated Cost Method,

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

Marshall Valuation cost schedule for apartments, Marshall Valuation Life Expectancy Guidelines. (Confidential.)

Petitioner's Exhibit – 3 – quantification analysis for grade reduction, photographs of subject building, 50 IAC 2.2-11-3 with Schedules A, B, and C.

Petitioner's Exhibit – 4 – Response to the income guidelines for tenants and documentation for filing date of petition.

Respondent's Exhibit – 1 – Letter correcting the numbering of the 131 petition to read the effective date of assessed value as of 3/1/00.

9. After the hearing, and by letter dated September 10, 2001, the State gave Rockville the opportunity to submit additional evidence demonstrating error in assessment. The letter is made part of the record and labeled Board Exhibit D. Rockville submitted information that is a part of the record and labeled Petitioner's Exhibit 5. The State notes, however, that this information is the same information contained in Petitioner's Exhibit 2. The local officials did not reply to Rockville's post-hearing submission.
10. As previously indicated, Rockville seeks a total reduction of 30% in assessment, perhaps by way of a 10% grade reduction and a grant of 20% obsolescence.
11. A calculation characterized as an income approach to value (Petitioner's Ex. 2) was provided indicating 30% obsolescence on the property.
12. A 10% grade reduction is sought due to differences between features identified in the model and not present in Rockville's apartments. See Petitioner's Ex. 3.
13. The Hearing Officer did not view the property.

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

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 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

These Findings Contain Confidential Information
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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

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

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. See also Ind. Code § 4-21.5-2-4(a)(10) (Though the State is exempted from the Indiana Administrative Orders & Procedures Act, it is cited for the proposition that Indiana follows the customary common law rule regarding burden).
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

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

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

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

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.

Conclusions Regarding Obsolescence Claim

The concept of depreciation and obsolescence

18. 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

¹ Depletion is the loss in value of property due to consumption of oil, gas, precious metals, and timber. IAAO Property Assessment Valuation, 153 (2nd ed. 1996).

These Findings Contain Confidential Information

Protected From Disclosure Under Ind. Code § 6-1.1-35-9

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.

19. 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.*
20. Functional obsolescence is a loss in value resulting from changes in demand, design, and technology. Functional obsolescence can take the form of deficiency (for example, only one bedroom), the need for modernization (for example, an outdated kitchen), or superadequacy (for example, overly high ceilings). *IAAO Property Assessment Valuation* at 154 & 155.
21. External or economic obsolescence is the loss of value resulting from factors external to the property (for example, national economic conditions). *IAAO Property Assessment Valuation* at 155.
22. Under the cost approach, there are five recognized methods used to measure depreciation, including obsolescence; namely: (1) the sales comparison method, (2) the capitalization of income method, (3) the economic age-life method, (4) the

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

modified economic age-life method, and (5) the observed condition (breakdown) method. *IAAO Property Assessment Valuation* at 156.

23. Regardless of the approach used to value property, and in the simplest of terms, the principle of substitution underlies all approaches to quantifying obsolescence. *IAAO Property Assessment Valuation*, 24 and Chapter 8, 155 – 186.

Burden for obsolescence claims

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 that obsolescence exists and (2) the taxpayer must quantify it. *Clark*, 694 N.E. 2d at 1233. If one or both requirements are not met, obsolescence is denied.

The income approach to value

26. Rockville attempted to use the Income Approach to support its obsolescence claim.
27. The Income Approach (sometimes referred to as capitalization of income) is widely used in appraising income producing properties. The anticipated future income is discounted to a present worth figure through the capitalization process. *IAAO Property Assessment Valuation* at 203.

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

28. Six basic steps are used in the Income Approach:
- Estimate potential gross income. Potential gross income is annual economic rent for the property at 100% 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 same area.
 - Deduct for vacancy and collection loss.
 - Add miscellaneous income to get the effective gross income.
 - Determine operating expenses.
 - Deduct operating expenses from the effective gross income to determine net operating income before discount, recapture, and taxes.
 - Select the proper capitalization rate.
 - Determine the appropriate capitalization procedure to be used.
 - Capitalize the net operating income into an estimated property value.

IAAO Property Assessment Valuation at 204.

29. The sixth step in the Income Approach – selection of the capitalization rate – requires careful attention because a small change in the rate, e.g., from 8 to 9%, can result in estimates of value differing by thousands of dollars. The capitalization rate is that return which a prudent investor would expect to receive in the present market and consists of a return on capital as well as a recapture of the investment. The capitalization rate can be broken down into three components: discount rate, recapture rate, and a tax rate. *IAAO Property Assessment Valuation* at 233.

30. The discount rate is the return on the investment. The rate reflects the compensation necessary to attract investors to give up liquidity, defer consumption, and assume the risk of investing. *IAAO Property Assessment Valuation* at 230.

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

31. The typical investment situation involves factors such as safety of investment and illiquidity of invested capital. Rockville's situation is not typical because the federal government is involved. At most, the borrower invested 10% equity so the borrower does not have much to lose. Risk is also related to the possibility of not realizing the projected future income. It is not clear as to guarantees made by the government in this situation, but there is a likelihood of a secure investment in this case.
32. The recapture rate is the return of investment – the return of invested capital. *IAAO Property Assessment Valuation* at 230. Rockville's recapture rate is limited because little capital was invested in the project (10% equity).
33. The effective tax rate is the ratio between the property value and the current tax bill. *IAAO Property Assessment Valuation* at 230.

The evidence presented

34. When looking at Rockville's situation logically, Rockville is being given a net income that is free and clear with minimal investment being made and with minimal risk being taken. The contention that Rockville is being penalized because of federally mandated restrictions is troublesome. Without the federal program in place, the apartment owner would have to come up with a sizeable down payment, incur risk, and illiquidity of his investment. The lower contract rent (if the rent is, in fact, lower for the area in which these apartments are located) is justified due to the lack of up-front commitment. The owner can also accept a lesser return because of the lack of (or nominal amount of) risk, investment and illiquidity.

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

35. The grant of obsolescence due to federally mandated restrictions is not automatic. *Pedcor Investments v. State Board of Tax Commissioners*, 715 N.E. 2d 432, 437 (Ind. Tax 1999)(Federal tax incentives must be taken into consideration when evaluating whether deed restrictions do, in fact, cause an apartment complex to experience economic obsolescence).
36. Rockville attempted to support the obsolescence claim through the Income Approach, but Conclusions, ¶¶ 27 – 33, reflect that capitalization is a sophisticated process. A thorough understanding of the Approach is necessary and substantiation of the capitalization rate used in the Approach is necessary.
37. Rockville’s calculation contains a capitalization rate (discount, recapture, and effective tax rates). Petitioner’s Ex. 2. But, rates must be supported in order to be meaningful and probative. Rockville had the opportunity to provide supporting documentation at both the administrative hearing and afterwards. See Board Ex. D. None was presented.
38. The State notes that it is not necessary to address other aspects of Rockville’s Income Approach due to the inadequacy of the capitalization rate.
39. Because Rockville’s Income Approach calculation is not supported, Rockville did not meet its burden with respect to its obsolescence claim. The decision of the PTABOA stands.

Conclusions Regarding Grade

40. The GCR model was used to determine base rate for these apartments. The GCR model includes sliding glass doors, which the apartments do not have. 50 IAC 2.2-11-3. Also, the apartments have 7’ wall heights instead of 9’ wall heights

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

described in the model. *Id.* Rockville seeks a grade reduction of 10% due to the differences between the model and the apartments.

Use of unit in place tables to account for lack of sliding glass doors

41. Property is valued on a mass appraisal basis. Mass appraisal is the appraisal of property on a wholesale scale, using standardized appraisal techniques and procedures to effect uniform and equal valuations with a minimum of detail, within a limited time period, and at limited cost. 50 IAC 2.2-1-35.
42. General mass appraisal models are an important part of Indiana's valuation method. Assessors select the model that best describes a particular building so the a base cost is determined. 50 IAC 2.2-10-6.1 (a model is a conceptual tool used to replicate reproduction cost of a given structure and assumes typical construction materials and certain elements of construction) and 2.2-11.
43. The Regulation limits the adjustments that may be made to the base cost to account for differences between the model and the building at hand. 50 IAC 2.2-10-6.1 and 11-6. (Schedules A through E).
44. Grade is also a method for adjusting cost. The general models in the Regulation are deemed average or C grade buildings. 50 IAC 2.2-10-3(b). Applying a grade higher or lower than C accounts for differences in construction specifications and the quality of materials and workmanship between the models in the Regulation and the building being assessed. 50 IAC 2.2-1-30 and 10-3 (grade is used to account for deviations from a C grade, and the quality and design of a building are the most significant variables in determining grade.)

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

45. The Tax Court invalidated the cost tables of the Regulation, holding that the Regulation did not contain ascertainable standards. *Town of St. John III*, 690 N.E. 2d at 1043. Nevertheless, the Supreme Court and the Tax Court did not throw out the system immediately, and property must be assessed under the current system. *Id.*
46. The Tax Court recognized the difficulty one might have in establishing grade, but held that it was the taxpayer's responsibility to provide probative and meaningful evidence to support a claim that the assigned grade factor was incorrect. *Bernacchi v. State Board of Tax Commissioners*, 727 N.E. 2d 1133 (Ind. Tax 2000).
47. The GCR apartment model provides for sliding glass doors. The unit in place table provides for economy sliding doors (\$387 each) and deluxe sliding doors (\$703 each). Rockville stressed that the apartments contained basic features without extra amenities; therefore, an adjustment will be made based upon economy sliding glass doors. Building A consists of (eight) 8 apartments multiplied by \$387 = \$3,096 / 5,782 square feet = \$0.56 negative adjustment. Building B consists of (eight) 8 apartments multiplied by \$387 = \$3,096 / 5,114 square feet = \$0.61 negative adjustment. Building C consists of twelve (12) units multiplied by \$387 = \$4,644 / 7,399 square feet = \$0.63 negative adjustment. Building D consists of eight (8) units multiplied by \$397 = \$3,096 / 5,025 square feet = \$0.62 negative adjustment.
48. Accordingly, there will be an adjustment to Building A of \$-0.56, to Building B of \$-0.61, Building C of \$-0.63, and Building D of \$-0.62. A change in the assessment is made as a result of this issue.

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9

Requested grade adjustment for wall height

49. Rockville seeks a grade adjustment based upon apartment wall height. Rockville does not point to a unit in place table adjustment, but calculates a proposed reduction based upon a 50 IAC 2.2-11-6 (Schedule A.2) adjustments for GCI properties. Petitioner's Ex. 3.
50. 50 IAC 2.2-11-6 (Schedule A.3) provides for adjustments from the square foot GCR base rate. Wall height adjustments are not provided for in the Schedule. The same rule, Schedule C, also provides for adjustments that *may* be made to base rate. Again, wall height adjustments are not provided for in the Schedule.
51. Rockville seeks a grade adjustment on the basis of wall height, but Rockville has not shown an adjustment permitted by the Regulation. Further, Rockville has not submitted probative evidence of grading error by pointing to a wall height different from the wall height listed in the GCR model.
52. For all of the reasons set forth above, an adjustment is made for the sliding glass doors but the grade assigned to the property stands.

Other Conclusions

58. Ms. Allen recognized the 131 petition was incorrectly numbered and corrected it. Respondent's Ex. 1.

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.

Chairman, Indiana Board of Tax Review

These Findings Contain Confidential Information
Protected From Disclosure Under Ind. Code § 6-1.1-35-9