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REPRESENTATIVE FOR PETITIONER:
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REPRESENTATIVE FOR RESPONDENT:
Marilyn S. Meighen, Nexus Group

**BEFORE THE
INDIANA BOARD OF TAX REVIEW**

Wesleyan Health Care Center, Inc.,)	Petition No.: 27-002-08-1-4-00015
)	
Petitioner,)	Parcel Nos.: 27-07-18-302-190.000-002
)	27-07-18-302-129.000-002
v.)	
)	County: Grant
Grant County Assessor,)	Township: Center
)	
Respondent.)	Assessment Year: 2008

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INDIANA BOARD
OF TAX REVIEW

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

September 19, 2012

FINAL DETERMINATION

The Indiana Board of Tax Review ("Board"), having reviewed the facts and evidence, and having considered the issues, now finds and concludes the following:

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Introduction

- Both parties offered valuation opinions from qualified appraisers in which those appraisers valued Wesleyan Health Care Center, Inc.'s nursing-home operation as a whole and then allocated that value between real property, tangible personal property,

and intangible personal property. Finding the opinion of Wesleyan's appraiser more reliable both as to the overall valuation and the allocation of that value to Wesleyan's real property, the Board holds that the nursing home's assessment must be lowered to 0.4. \$3,006,100.

Procedural History

2. This appeal originally involved two parcels: Parcel 27-07-18-302-190.000-002, which contains Wesleyan's main building, and Parcel 27-07-18-302-129.000-002, which contains an ancillary building that Wesleyan uses for storage. Wesleyan listed both parcel numbers on the Form 130 petition that it filed at the local level. On September 18, 2009, the Grant County Property Tax Assessment Board of Appeals ("PTABOA") issued a single determination for both parcels denying Wesleyan relief. Wesleyan then filed a single Form 131 petition with the Board, again listing both parcels.
3. Wesleyan also appealed both parcels' assessments for the March 1, 2009 and March 1, 2010 assessment dates. But for those appeals, Wesleyan filed separate petitions for each parcel. For reasons discussed below, the Board's designated administrative law judge, Joseph Stanford ("ALJ") held two separate hearings—one on Wesleyan's petition for the 2008 assessment year, and one on Wesleyan's petitions for 2009 and 2010.
4. Shortly before the Board's hearings, Wesleyan filed a request "to withdraw the Petition 131's for Wesleyan Health Care Center, Inc.'s 2008 (pay 2009) 2009 (pay 2010), and 2010 (pay 2011) assessments" for the ancillary parcel. The Board issued final determinations granting the withdrawal of those petitions for the 2009 and 2010 assessment years. But there was no separate request to withdraw the Form 131 petition for the ancillary parcel's March 1, 2008 assessment. Nonetheless, the parties and the ALJ only addressed Wesleyan's appeal of the main parcel (Parcel 27-07-18-302-190.000-002) at the Board's hearing.
5. In light of those circumstances, the Board will grant Wesleyan's request to withdraw its appeal of the ancillary parcel's 2008 assessment, even though it did not file that appeal on

a separate Form 131 petition. That is the course that best reflects the parties' intent. Thus, this Final Determination addresses only the main parcel's assessment. It deals with the ancillary parcel only to grant Wesleyan's request to withdraw its appeal as to that parcel.

6. The following people testified under oath:

For Wesleyan: Mark S. Bovee, appraiser, All Appraisals, Inc.
Thomas P. Morlan, appraiser, R.E. Research Associates
Dave Schaadt, certified tax representative, Integrity
Financial & Tax Consulting

For the Assessor:¹ Leo E. Lichtenberg, appraiser, Advisio

7. Wesleyan submitted the following exhibits:

Petitioner Exhibit 1: Listing of Appraisal Institute Designated Members who have passed the *Valuation of the Components of a Business Enterprise Professional Development Program* examinations
Petitioner Exhibit 2: Appraisal of subject property prepared by Mark S. Bovee
Petitioner Exhibit 3: Subject property record card

8. The Assessor submitted the following exhibits:

Respondent Exhibit A: Appraisal of subject property prepared by Leo E. Lichtenberg
Respondent Exhibit B: Excerpts from *The Appraisal of Nursing Facilities* by James A. Tellatin, MAI

9. All pleadings and documents filed in Wesleyan's appeal as well as all orders and notices issued by the Board or its ALJ are part of the record, as are the digital recordings of the Board's hearings.

10. The PTABOA determined the following assessment for Wesleyan's property:

Land: \$18,200 Improvements: \$5,586,100 Total: \$5,604,300²

¹ Tamara Martin, Grant County Assessor, appeared at the hearing, but she was not sworn in and did not testify.

² That number is a little confusing, because the PTABOA addressed both the main and ancillary parcels in its determination. In the body of its determination, the PTABOA indicates that "BOARD VOTED TO MAKE NO CHANGES," yet the values reflected on the determination's first page exactly mirror the values on the property record card for the main parcel. That appears to leave nothing attributable to the ancillary parcel.

11. At hearing, Wesleyan requested an assessment of \$3,006,060.
12. Neither the Board nor the ALJ inspected Wesleyan's property.

Findings of Fact

A. Wesleyan's property

13. The property under appeal, known as Wesleyan Healthcare Center, is located in Marion. The Indiana Department of Health has licensed Wesleyan's facility for 169 beds. The facility also contains eight assisted-living units with 16 beds. The ancillary building is used mainly for storage. The facility was built in three stages during the following years: 1961, 1973, and 1985. *Bovee testimony; Pet'r Ex. 2 at iii; Resp't Ex. A at 10.*
14. The parties offered appraisal reports and testimony from two appraisers. The Assessor hired Leo E. Lichtenberg to appraise Wesleyan's property, while Wesleyan hired Mark S. Bovee to do the same. Wesleyan also offered testimony from Thomas P. Morlan, who was hired to review Lichtenberg's appraisal. The Board therefore turns to the appraisers' respective valuation opinions.

B. Lichtenberg's opinion

15. Lichtenberg is a Member of the Appraisal Institute ("MAI"), a certified general appraiser, a licensed broker, and a member of the Indiana Association of Realtors. He has been appraising property for about 20 years and has appraised between 20 and 50 nursing homes. *Lichtenberg testimony; Resp't Ex. A, Addendum D.*
16. Lichtenberg certified that he appraised Wesleyan's property in conformity with the Uniform Standards of Professional Appraisal Practice ("USPAP"). He completed a summary appraisal report and applied all three generally recognized approaches to value—the cost, the sales-comparison, and income approaches. *Lichtenberg testimony; Resp't Ex. A at 16-17, 78, 85-111, 120.*

17. In his cost approach analysis, Lichtenberg estimated the value of Wesleyan's land, as if vacant, at \$184,000. He based that estimate on sales of vacant land from the same market area. *Lichtenberg testimony; Resp't Ex. A at 79, 84.* Lichtenberg then relied on Marshall Valuation Service ("MVS") to estimate the replacement cost for Wesleyan's improvements. He used MVS costs applicable to February 2012, and adjusted those costs downward by 5.7% to relate back to March 1, 2010.³ To value furniture, fixtures, and equipment ("FF&E"), Lichtenberg analyzed two sales, which indicated an unadjusted range of \$ [REDACTED] to \$ [REDACTED] per bed. Given the age of the facilities involved in those sales, he estimated depreciation at 50-75%, indicating a range of \$ [REDACTED] to \$ [REDACTED] per bed for cost new. In addition, MVS reported that recent nursing home construction can include FF&E of \$ [REDACTED] to \$ [REDACTED] per bed with a mean of \$ [REDACTED], and other research indicated that MVS's data was typical for low- to mid-range facilities. Giving the most weight to the MVS figures, Lichtenberg settled on a rate of \$ [REDACTED] per unit, or total cost new for FF&E of \$ [REDACTED]. *Lichtenberg testimony; Resp't Ex. A at 85*
18. MVS costs, however, do not include indirect costs or entrepreneurial incentive, and Lichtenberg felt that he needed to include those two items in his analysis. He estimated indirect costs at 5% of hard costs. As to entrepreneurial incentive, Lichtenberg simply noted that the amount varies from developer to developer and often ranges from zero to 20% of hard costs. He settled on 10% for Wesleyan's property. Finally, Lichtenberg estimated 40% depreciation for building improvements, 60% for FF&E, and 50% for site improvements. He observed no functional or external obsolescence. *Lichtenberg testimony; Resp't Ex. A at 86-87.*
19. After taking all of those things into account, Lichtenberg's cost-approach analysis indicated a March 1, 2010 value of \$ [REDACTED]. *Lichtenberg testimony; Resp't Ex. A at 87.*

³ As discussed above, Wesleyan appealed its assessments for 2008-2010. March 1, 2010 is the latest valuation date that Lichtenberg addressed in his appraisal. While these findings only deal with Wesleyan's appeal of the March 1, 2008 assessment, the parties tried the 2008 appeal with an eye toward incorporating much of their evidence into the other appeals. The Board will issue a separate determination for Wesleyan's appeals of the 2009 and 2010 assessment dates.

20. Lichtenberg then turned to the sales-comparison approach. He identified what he viewed as five comparable Indiana facilities that sold from 2004 to 2009. One was located in Marion and the others were located in Lafayette, Delphi, Clinton, and Alexandria.
21. Lichtenberg determined that price-per-bed was the most common measure of comparison. Using that measure, he compared the sold facilities to Wesleyan's facility along several lines, including financing terms, market conditions, government regulation, licensing, age, occupancy, and condition. He also compared the facilities based on the mix of revenue among private pay, Medicaid, and Medicare patients, which he referred to as the property's "census." *Resp't Ex. at 97*. A facility's census is significant because private-pay patients are required by law to pay higher rates than what the government pays for Medicaid patients. Private-pay patients also require less paperwork. Similarly, Medicare rates generally are higher than Medicaid rates. *Id. at 95; Lichtenberg testimony*.
22. While Lichtenberg did not quantify any adjustments to reflect relevant differences between the sold facilities and Wesleyan's facility, he did qualitatively rank the facilities along those lines. The other facilities sold for prices ranging from \$ [REDACTED] to \$ [REDACTED] per unit. He settled on a price of \$ [REDACTED] per unit, which translated to a rounded March 1, 2010 value of \$ [REDACTED] for Wesleyan's facility. *Lichtenberg testimony; Resp't Ex. A at 94-98*.
23. Next, Lichtenberg analyzed Wesleyan's facility using the income approach. He started with the facility's earnings before interest, taxes, depreciation, and amortization ("EBITDA"), which he explained is interchangeable with net operating income ("NOP") and cash flow. The fact that statistical information on nursing homes is based on sales data that includes business operations implies there is no separate rent for real estate. Thus, EBITDA and EBITDAR ("R" stands for rent) are basically the same. There is a

lease on Wesleyan's property, but it is not at arm's length.⁴ *Lichtenberg testimony; Resp't Ex. A at 99.*

24. Lichtenberg used the facility's history to determine a patient census and occupancy levels. To develop pay rates for intermediate and assisted living care, he consulted annual facility reports filed with Myers & Stauffer, an accounting firm that contracts with the State of Indiana to handle all Medicaid expense statements. Giving the greatest weight to the most recent statements, Lichtenberg calculated an effective gross income of \$ [REDACTED] from Wesleyan's nursing-home beds and \$ [REDACTED] from its assisted living beds, for a total of \$ [REDACTED]. He felt that income was reasonable given the facility's historic performance. *Lichtenberg testimony; Resp't Ex. A at 99-107.*
25. Lichtenberg then turned to expenses. He estimated expenses based on actual data that Wesleyan provided. Lichtenberg analyzed expenses on a per-unit basis, again giving the most recent statements the most weight. He did not include real estate taxes. For replacement reserves, Lichtenberg consulted the *Senior Care Acquisition Report* published by Irving Levin Associates, Inc., in 2011, and the historical average for Wesleyan's facility. Based on that information, Lichtenberg calculated expenses of \$ [REDACTED] for the nursing-home beds and \$ [REDACTED] for the assisted-living beds, for a total of \$ [REDACTED]. Deducting total expenses from total revenue left NOI of \$ [REDACTED]. *Lichtenberg testimony; Resp't Ex. A at 108-09.*
26. To reduce that NOI to an opinion of value, Lichtenberg used the direct capitalization approach, which he explained is what investors use when making investment decisions. Comparable sales yielded capitalization rates ranging from 10.98% to 15.89%, with an average of 12.91%. Lichtenberg found support for that range by consulting investor and broker surveys, and he settled on a rate of 12.5%. He then loaded that rate by 2.0779% to account for property taxes, which resulted in a loaded rate of 14.5779%. Lichtenberg

⁴ Bovee's appraisal also indicates that the lease on the property is between affiliated parties and therefore not at arm's-length. *Pet'r Ex. 2 at 20.*

applied that loaded rate to the property's NOI to reach a March 1, 2010 value of \$ [REDACTED] *Lichtenberg testimony; Resp't Ex. A.*

27. In reconciling his three value estimates, Lichtenberg concluded that the income approach was the best indicator of value, while the cost approach was the weakest. With that in mind, he estimated the facility's March 1, 2010 overall value at \$ [REDACTED] *Lichtenberg testimony; Resp't Ex. A at 111.*
28. But Lichtenberg's analysis did not end there. Because only real estate is assessable for ad valorem taxation, Lichtenberg explained that he needed to allocate the facility's overall value between real estate, FF&E, and intangible business assets, such as Wesleyan's assembled workforce, licenses, certifications, patient records, management, and goodwill. According to Lichtenberg, nursing homes normally sell as going concerns with all of the tangible and intangible property interests transferring together, and the parties to those sales tend to keep the details private. The value of the whole is typically greater than the sum of the parts, and there is no single recognized method for allocating a nursing home's value among its various components. *See Lichtenberg testimony; Resp't Ex. A at 112.*
29. Lichtenberg chose the "entrepreneurial or proprietary profit capitalization approach" to make his allocation. *Resp't Ex. A at 112; see also Lichtenberg testimony.* That approach is explained in *The Appraisal of Nursing Facilities*, a book written by James K. Tellatin, MAI, and published by the Appraisal Institute. Under that approach, some appraisers determine intangible value by deducting entrepreneurial profit from NOI or EBITDAR and capitalizing that deducted income.
30. To determine what amount to deduct from NOI, Lichtenberg looked to three sources: (1) the 10% allowance for entrepreneurial profit that he used in his cost-approach analysis; (2) information from an Appraisal Institute seminar indicating that skilled nursing facilities typically rent for 80% to 85% of NOI; and (3) *The Appraisal of Nursing Facilities*. The last source indicates that, in determining loan amounts for FHA-insured

mortgages offered under its Multifamily Accelerated Processing program, the Department of Housing and Urban Development (“HUD”) has mandated that a minimum of 15% of NOI be excluded through a proprietary-earnings deduction. Lichtenberg settled on 15% of NOI, or \$ [REDACTED] as the amount to deduct and capitalize for purposes of estimating the value of Wesleyan’s intangible assets. *Lichtenberg testimony; Resp’t Ex. A at 112; Resp’t Ex. B at 1, 316.*

31. To determine an appropriate capitalization rate, Lichtenberg found that capitalization rates for businesses with strong earnings and good market support often range from 12% to 20% while rates for unproven businesses in volatile markets trade at rates between 25% and 50%. Because nursing homes generally do not sell intangibles separately from real estate, Lichtenberg looked to sales of other types of healthcare providers that do not have real estate assets and found capitalization rates ranging from 19% to 37%. He also looked to an article written by Tellatin and C. Wark Hansen that indicated rates between 20% and 33%. Lichtenberg settled on a capitalization rate of 25%, which, when applied to the \$ [REDACTED] of NOI that he attributed to proprietary earnings, yielded a rounded intangible asset value of \$ [REDACTED]. *Lichtenberg testimony; Resp’t Ex. A at 113.*
32. Lichtenberg then subtracted that amount and the \$ [REDACTED] depreciated value of the FF&E from his overall value estimate, leaving a March 1, 2010 value of \$ [REDACTED] for Wesleyan’s real property. *See Lichtenberg testimony; Resp’t Ex. A at 113.*
33. Finally, Lichtenberg trended that value back to January 1, 2007, the valuation date for the March 1, 2008 assessment under appeal in this case, as well as to January 1, 2008, the valuation date for a separate appeal filed by Wesleyan. In doing so, Lichtenberg considered changes both in capitalization rates and in Wesleyan’s NOI between March 1, 2010, and the other two valuation dates. He found that the unloaded capitalization rate for the business as a whole was .25% lower in 2008 and 1.00% lower in 2007. He also found a substantial difference in the property’s NOI—\$ [REDACTED] for 2008 compared to \$ [REDACTED] for 2010 and \$ [REDACTED] for 2007. That led Lichtenberg to estimate overall values of \$ [REDACTED] for January 1, 2008 and \$ [REDACTED] for January 1, 2007, and

corresponding real property values of \$ [REDACTED] and \$ [REDACTED] for those respective dates. *Lichtenberg testimony; Resp't Ex. A at 114-120.*

C. Morlan's critique of Lichtenberg's opinion

34. Morlan is a certified appraiser and is a principal of R.E. Research Associates, an appraisal firm in Lafayette, Indiana. He holds several professional appraisal designations. Morlan estimated that he has personally completed more than 10,000 appraisals over 40 years. He has written coursework for and taught Appraisal Institute courses, although he now concentrates mainly on consulting. *Morlan testimony.* Morlan testified that he performed a "narrow scope" review of Lichtenberg's appraisal, which is governed by USPAP Standard 3. *Morlan testimony.*
35. Morlan is very familiar with the city of Marion and believes that "Marion goes as the auto industry goes." *Morlan testimony.* While that creates potential volatility, Morlan was very concerned with the volatility of real estate values in Lichtenberg's report as well as with the direction of that volatility. More specifically, Morlan was concerned that Lichtenberg's report showed the value of Wesleyan's real property going from \$ [REDACTED] on January 1, 2007, to \$ [REDACTED] on January 1, 2008. Morlan would expect some volatility, but not a 50% increase in one year. That is particularly true where Lichtenberg's appraisal covered a four-year period that included the largest recession since the Great Depression. *Morlan testimony.*
36. Also, Lichtenberg's analysis reflected the volatility mostly in Wesleyan's real estate. But to the extent that type of volatility occurs, it is likely in the non-real-estate assets. In any case, Morlan saw nothing in Lichtenberg's appraisal report to explain—much less to support—the type of volatility that Lichtenberg found. According to Morlan, when an appraiser introduces that type of volatility into his report, he must walk the reader through it. *Morlan testimony.*
37. While Morlan generally has no problems with retrospective appraisals, he disagreed with Lichtenberg's method of determining a value for March 1, 2010, and then trending that

value back to earlier dates. According to Morlan, Lichtenberg should have examined each year incrementally. Morlan also felt that a discounted-cash-flow analysis would have helped, particularly in light of the volatility that Lichtenberg found. A retrospective appraisal must be done “without a memory,” so that the appraiser will not be biased by events that had not yet occurred as of the valuation date. *Morlan testimony*. Thus, if Lichtenberg’s January 1, 2008 value is right, then his January 1, 2007 value is wrong, because an investor in 2007 likely would have anticipated what ended up happening in the following year. *Id.* In 2010, by contrast, an investor would have likely felt that things were coming out of the “valley of the shadow of death.” *Id.* In 2010, investment bankers, real estate investment trusts, and “equity people” were starting to think about how to get into the nursing home industry, whereas in 2008, nobody could sell or finance anything. *Id.*

38. Morlan also had several problems with Lichtenberg’s cost-approach analysis. For example, Lichtenberg simply took a weighted age for the entire main building rather than doing a segregated cost analysis and looking at short-lived items separately. According to Morlan, those short-lived items are big operating expenses for nursing homes. Similarly, Morlan would expect to find at least some functional obsolescence in a nursing home as old as Wesleyan’s. As Morlan explained, unlike Wesleyan’s older building, everything being built now is energy efficient. Morlan saw nothing in Lichtenberg’s appraisal report to convince him that Wesleyan’s main building does not suffer from at least some functional obsolescence. *See Morlan testimony*.
39. Lichtenberg’s decision not to include any external obsolescence also gave Morlan pause. Lichtenberg’s appraisal covered a period during which cities that depend on the automobile industry were hard hit. Morlan believes that appraisers valuing properties in those cities need to address economic obsolescence on a city-by-city basis. According to Morlan, many of the automobile-industry workers in Marion came from other states where they still maintained houses that they could not sell. And their pensions were reduced. Given those circumstances, those workers would not likely become private-pay patients. *Morlan testimony*.

40. Morlan further explained that entrepreneurial incentive, which is something that Lichtenberg included in his analysis, is very difficult to quantify and should be supported by compelling evidence. Morlan would not include any entrepreneurial incentive. *Morlan testimony.*
41. Morlan was similarly troubled by Lichtenberg's sales-comparison analysis. Lichtenberg included two sales that were part of single transaction involving a portfolio of nursing homes. Thus, Lichtenberg's sale prices reflected how the parties to the sale allocated the sale price among the various properties. But Morlan explained that the parties to portfolio sales may not always agree as to precisely what was bought and sold, and their allocation may reflect other factors, such as attempts to gain favorable tax treatment. Thus, Morlan testified that before using allocated sale prices from a portfolio transaction, an appraiser should talk to the people involved. Also, the portfolio properties in Lichtenberg's appraisal were bought by Trilogy, an aggressive operator of high-end nursing homes. *Morlan testimony.*
42. Morlan likewise had concerns about the price range that Lichtenberg derived from his comparable sales. Because Lichtenberg did not quantitatively adjust the sale prices, he ended up with ranges that you could "drive a truck" through. *Morlan testimony.* There were ways to narrow that range, but Morlan acknowledged that it would have been tough because there were not many sales. *Id.*
43. Turning to Lichtenberg's analysis under the income approach, Morlan was troubled that Lichtenberg relied on data from Myers & Stauffer to determine pay rates for the different types of patients (private pay, Medicare, Medicaid, etc.). Morlan was leery of the potential for skewed data, so he would have pulled out the data for the more recently built facilities. Indeed, Morlan explained that appraisers generally need to be careful when using aggregate data, such as the data used in nationally published reports. Many of those reports address investment-grade properties of the type that pension funds and Real

Estate Investment Trusts deal in rather than B- or C-grade properties like Wesleyan's.
Morlan testimony.

44. Further, Morlan felt that, in estimating expenses for Wesleyan's property, Lichtenberg should have relied more on nursing homes from Wesleyan's market rather than on statewide averages. And Lichtenberg applied a single capitalization rate to the whole business. But volatility from changes in the patient mix is probably attributable to the business instead of the real estate. Thus, the capitalization rate for the intangible business assets should have been much higher than the rate that applied to the real estate. *Morlan testimony.*
45. Finally, Morlan observed that Tellatin's approach for allocating intangible value, which Lichtenberg relied on in allocating the overall value of Wesleyan's facility between tangible and intangible property components, is just one man's opinion. The Appraisal Institute eliminated Tellatin's course on valuing nursing homes after one year because it was creating too much of an uproar among practitioners. Ultimately, Morlan was not satisfied with how Lichtenberg allocated value to intangible property; he did not see adequate transparency in Lichtenberg's report. *Morlan testimony.*
46. Overall, Morlan concluded that Lichtenberg's valuation opinion was not well supported and testified that he would not rely on that opinion for taxation purposes. *Morlan testimony.*

D. Bovee's opinion

47. Bovee is an MAI and a licensed general appraiser. He has taken many courses relating to the valuation of business and intangible assets, and is one of only six people in Indiana to have passed an Appraisal Institute course entitled *Valuation of the Components of a Business Enterprise*. He has appraised approximately 10 nursing homes. *Bovee testimony; Pet'r Ex. 1.*

48. Like Lichtenberg, Bovee certified that he completed his appraisal in conformity with USPAP. *Pet'r Ex. 2 at 1*. While Bovee considered all three approaches to value and actually did a cost-approach analysis, he did not include the cost approach in his appraisal report. At the Board's hearing, Bovee testified that his cost approach analysis preceded a value of approximately \$ [REDACTED] but that he did not include the entrepreneurial profit in that computation *Bovee testimony*. Bovee, however, did testify to his belief that the facility suffered from some functional obsolescence. He pointed to the fact that the facility had been built in phases, with each phase crating a new plant design, duplicated interior and exterior walls, and new roof lines. *Bovee testimony*.
49. For his sales-comparison approach, Bovee selected five Indiana sales from 2005-2006 and one from 2007. The sales were from Fort Wayne, Kokomo, Madison, Martinsville, Scottsburg, and Washington. Unlike Lichtenberg, Bovee quantitatively adjusted his sale prices to account for differences in such things as effective age, patient census, and whether the sale was part of a portfolio transaction. Bovee explained his portfolio adjustment on grounds that portfolio sales across different states can be manipulated toward states and jurisdictions with low or no transfer taxes. In addition, buyers often achieve synergies of management and economies of scale, and real estate investment trusts often buy in bulk because of deferred tax issues. Thus, portfolio buyers often pay significant premiums that must be removed to reflect a typical market transaction. *Pet'r Ex. 2 at 75*.
50. Like Lichtenberg, Bovee used price-per-bed as his unit of comparison, and his adjusted sale prices ranged from \$ [REDACTED] to \$ [REDACTED] per bed. Bovee settled on a price of \$ [REDACTED] per bed for Wesleyan's nursing home beds. He then capitalized the income from the 16 assisted living beds and added that amount to the value from the nursing home beds to arrive at a total value of \$ [REDACTED] *Bovee testimony; Pet'r Ex. 2 at 60-76*.
51. In his analysis under the income approach, Bovee paid particular attention to the patient census. He looked to Wesleyan's historic rates for Medicaid, Medicare and private-pay patients. He also looked to other sources, such as the private-pay rates for competing

expense analysis on state-wide expense reports provided to Myers & Stauffer. As with his income analysis, Bovee paid particular attention to nursing homes from the same area as Wesleyan's facility because they are affected by similar market conditions and wage rates. After deducting expenses from his estimated revenues, Bovee estimated NOI/EBITDAR for the nursing home beds of [REDACTED] *Bovee testimony; Pet'r Ex. 2 at 77-91.*

52. Like Lichtenberg, Bovee used direct capitalization. He looked at 16 nursing home sales from Indiana and extracted a mean overall capitalization rate of 17.04%. He also considered two other methods—the band-of-investment method, which yielded an overall rate of 15.5%, and the debt-coverage-ratio method, which yielded an overall rate of 19.5%. Bovee settled on an overall rate of 17%, which he applied to the estimated NOI for the nursing home beds. To that sum, Bovee added the capitalized income from the assisted living units to arrive at an estimate of \$[REDACTED] for the facility as a whole. *Bovee testimony; Pet'r Ex. 2 at 92-95.*
53. In reconciling his values, Bovee gave the most weight to his conclusions under the income approach and settled on a January 1, 2007 value of \$[REDACTED] for the business as a whole. *Bovee testimony; Pet'r Ex. 2 at 96.*
54. Like Lichtenberg, Bovee then set about allocating that overall value between the real estate and the non-real estate assets, which included FF&E, and intangible personal property. Bovee identified three intangible property components: (1) Wesleyan's assembled workforce, (2) its licenses, permits, and regulatory approvals, and (3) goodwill. Bovee separately allocated value to the first two components. But he explained that goodwill is allocated at the time of purchase and is a residual value after the real property, tangible personal property, and intangible assets have been removed from the sale price. *Bovee testimony; Pet'r Ex. 2 at 97-102.*
55. Bovee used the cost approach to isolate the value of Wesleyan's assembled workforce. He explained that nursing homes are labor-intensive businesses and have a high turnover

rate, so the costs for recruiting, screening, hiring, and training employees are high. After analyzing Wesleyan's workforce, the local labor market, and costs for recruiting, screening and hiring, Bovee computed a total workforce cost of \$ [REDACTED] *Bovee testimony; Pet'r Ex. 2 at 97-99.*

56. Next, Bovee valued Wesleyan's licenses, permits, and regulatory approvals by using the "relief from royalty method," which assumes that assets are loaned or leased to a third party who can then operate its business under those regulatory approvals. Bovee explained that, while Indiana "per se does not require a CON Certificate of Need for a skilled nursing facility," there are still many regulatory issues to consider. *Pet'r Ex. 2 at 100.* According to Bovee, certificates of need are frequently bought and sold in some states and command significant value. In other states, they are not transferrable but still retain significant value to the user. *Id.*
57. Bovee's first step was to estimate a royalty rate for the facility's licenses, permits and regulatory approvals. Because "royalty rates for arms length transactions involving Indiana Skilled Nursing facilities are difficult to capture from the market," Bovee used hotel franchising as a proxy. *Bovee testimony; Pet'r Ex. 2 at 100.* He looked at royalty rates for various hotel franchises that ranged from 3% to 7% of room revenue. Because nursing homes tend to have thinner margins and do not have the same investment in brand name as hotels do, Bovee settled on a 3% royalty rate for Wesleyan's licenses, permits and approvals. That translated to \$ [REDACTED] per bed, or a total value of \$ [REDACTED]. *Bovee testimony; Pet'r Ex. 2 at 100-01.*
58. For FF&E, Bovee estimated a cost of \$ [REDACTED] per bed or a replacement cost of \$ [REDACTED]. *Pet'r Ex. 2 at 104.*
59. Next, Bovee explained that because assessments bear a direct relationship to market value-in-use, an ad valorem analysis requires deducting the income necessary to support the real property component of the facility, the taxes paid, and the effective tax rate. The effective tax rate bears directly on real estate value. Where taxes themselves are in

dispute, such as in a property tax appeal, they can be accounted for by applying an income approach where the actual taxes are deducted from the expense statement and the capitalization rate is instead loaded by the effective tax rate. That method neutralizes the impact of the disputed taxes on a property's value. *Bovee testimony; Pet'r Ex. 2 at 103.*

60. Thus, to value Wesleyan's residual real estate using the income approach, Bovee needed to remove the income attributable to non-realty items. He did that through multiplying each non-realty component's overall value by a rate of return consistent with the component's risk. According to Bovee, a 25% return was appropriate for the intangible components, reflecting the fact that those components are highly perishable. And he chose an 18% rate for FF&E. Using those rates, he arrived at NOI of \$ [REDACTED] to support the identified intangibles and FF&E. Deducting that amount from the business's overall NOI (and adding \$ [REDACTED] for real estate taxes) left NOI of \$ [REDACTED] to support Wesleyan's real estate. Bovee then adjusted that NOI by deducting a management fee and reserves and adding rental income for the assisted-living beds. *Bovee testimony; Pet'r Ex. 2 at 103-06.*
61. Next, Bovee developed another capitalization rate—one that reflected the risk for the real property only. To that end, he consulted surveys that reported real estate capitalization rates for a wide variety of properties. Bovee settled on a rate of 10%, which translated to a loaded capitalization rate of 13.45%. When Bovee divided the real property's adjusted NOI of \$ [REDACTED] by that capitalization rate, he arrived at a January 1, 2007 real property value of \$ [REDACTED]. *Bovee testimony; Pet'r Ex. 2 at 103-06.*
62. Bovee explained that his allocation of the business value between real property and intangible assets is supported under USPAP Standards 9 and 10. According to Bovee, the relief from royalty method is used before federal courts in tax disputes and infringement cases and the cost approach to valuing an assembled workforce is used in estate and gift tax cases when valuing stock or closely held businesses. *Bovee testimony.*

Conclusions of Law and Analysis

A. Burden of Proof

63. Generally, a taxpayer seeking review of an assessing official's determination must make a prima facie case proving both that the current assessment is incorrect and what the correct assessment should be. *See Meridian Towers East & West v. Washington Twp. Assessor*, 805 N.E.2d 475, 478 (Ind. Tax Ct. 2003); *see also, Clark v. State Bd. of Tax Comm'rs*, 694 N.E.2d 1230 (Ind. Tax Ct. 1998). Effective July 1, 2011, however, the Indiana General Assembly enacted Ind. Code § 6-1.1-15-17, which has since been repealed and re-enacted as Ind. Code § 6-1.1-15-17.2.⁵ That statute shifts the burden to the Assessor in cases where the assessment under appeal has increased by more than 5% from its previous year's level.

This section applies to any review or appeal of an assessment under this chapter if the assessment that is the subject of the review or appeal increased the assessed value of the assessed property by more than five percent (5%) over the assessed value determined by the county assessor or township assessor (if any) for the immediately preceding assessment date for the same property. The county assessor or township assessor making the assessment has the burden of proving that the assessment is correct in any review or appeal under this chapter and in any appeals taken to the Indiana board of tax review or to the Indiana tax court.

I.C. § 6-1.1-15-17.2.

64. There is no dispute that the property's assessment increased more than 5% between March 1, 2007, and March 1, 2008.⁶ But the parties disagree about whether Ind. Code § 6-1.1-15-17.2 applies to this proceeding. In Wesleyan's view, the statute should apply because the hearing was held after the statute's original effective date. The Assessor, by contrast, argues that the statute should first apply to appeals of assessments made in 2012.

⁵ HEA 1009 §§ 42 and 44 (signed February 22, 2012). This was a technical correction necessitated by the fact that two different provisions had been codified under the same section number.

⁶ According to the parties, the subject property's March 1, 2007 assessment was approximately \$1.6 million. The property record card shows a 2007 assessment of \$1,637,600. *Resp't Ex. 3*.

65. The Board has answered that question in several decisions. *See e.g., Echo Lake, LLC v. Morgan County Assessor*, pet. nos. 55-016-09-1-4-00001 -02 and -03 (Ind. Bd. of Tax Rev. Nov. 4, 2011) and *Stout v. Orange County Assessor*, pet. no. 59-007-09-1-5-00001 (Ind. Bd. Tax Rev. Nov. 7, 2011). In each case, the Board held that Ind. Code § 6-1.1-15-17 applied to appeals where the Board conducted its hearing after July 1, 2011, even if the assessment under appeal was made before that date. *Id.* As explained in those decisions, ““While statutes are generally given prospective effect absent a contrary legislative intent, it is also true that the jurisdiction in pending proceedings continues under the procedure directed by new legislation where the new legislation does not impair or take away previously existing rights, or deny a remedy for their enforcement, but merely modifies procedure, while providing a substantially similar remedy.”” *Echo Lake*, slip op. at 8-9 (quoting *Tarver v. Dix*, 421 N.E.2d 693, 696 (Ind. Ct. App. 1981)). According to the U.S. District Court for the Northern District of Indiana, “applying newly enacted procedure to a case awaiting trial in district court is not, strictly speaking, a retroactive application of the law” because the court has not yet “done the affected thing” when the new law is applied. *Brown v. Amoco Oil Co.*, 793 F. Supp. 846, 851 (N.D. Ind. 1992).
66. The Board’s decisions also point to *City of Indianapolis v. Wynn*, 157 N.E.2d 828, 834-835 (Ind. 1959), where the Indiana Supreme Court held that a statutory amendment specifying that evidence of certain factors constituted primary determinants of an annexation’s merit applied to a proceeding where the remonstrators had filed their challenge to the annexation, but no hearing had yet occurred. The Court reasoned that because the amendment “changes the method of procedure and elements of proof necessary to sustain an annexation ordinance, and does not change the tribunal or the basis of any right, it must be presumed that the Legislature intended that the proceedings instituted under the [prior version of the statute] should be continued to completion under the method of procedure prescribed by the [amendment].” *Id.*, see also *Tarver v. Dix*, 421 N.E.2d 693, 696 (Ind. Ct. App. 1981) (A statutory presumption of legitimacy applied to a case filed prior to its enactment but heard after the legislation was passed because

“the new legislation ... provided a substantially similar remedy while delineating more clearly the procedure to be followed in determining and enforcing this right.”).

67. Indiana Code § 6-1.1-15-17.2 does not change the rules or standards for determining whether an assessment is correct. Nor does it change an assessor’s duties in making assessments. Assessors must assess real property based on its “true tax value” which, for most types of property is defined as “the market-value-in use of a property for its current use, as reflected by the utility received by the owner or a similar user, from the property.” 2002 REAL PROPERTY ASSESSMENT MANUAL at 2 (incorporated by reference at 50 IAC 2.3-1-2 (2009)). This definition “sets the standard upon which assessments may be judged.” *Id.* Moreover, property values are to be adjusted each year to reflect the change in a property’s value between general reassessment years. *See* Ind. Code § 6-1.1-4-4.5. The question of whether the assessor will have the burden of proof at hearing based on how much a property’s value changes year over year should not affect the assessor’s obligation to assess the property according to its market value-in-use.
68. Thus, the “affected thing” under Ind. Code § 6-1.1-15-17.2 is the evidentiary hearing wherein the Board evaluates the proof offered by the parties—not the assessor’s act of valuing the property in the first place.
69. Consequently, Ind. Code § 6-1.1-15-17.2 applies to all appeals that had not been heard as of July 1, 2011. Because the property’s March 1, 2008 assessment increased by more than 5% over its assessment for the previous year, the Assessor has the burden of proof in this appeal.

B. Merits

70. As explained above, Indiana assesses real property based on its market value-in-use. MANUAL at 2. Thus, a party’s evidence in an assessment appeal must be consistent with that standard. *See id* at 5. For example, a market-value-in-use appraisal prepared according to USPAP often will often be probative. *Kooshtard Property VI*, 836 N.E.2d at 506 n. 6. A party may also offer actual construction costs, sales information for the

subject or comparable properties, and any other information compiled according to generally accepted appraisal principles. MANUAL at 5. Regardless of the type of evidence that a party relies on, the party must explain how its evidence relates to the property's market value-in-use as of the relevant valuation date. *O'Donnell v. Dep't of Local Gov't Fin.*, 854 N.E.2d 90, 95 (Ind. Tax Ct. 2006). Otherwise, the evidence lacks probative value. *Id.* For March 1, 2008 assessments, the valuation date was January 1, 2007. *See* 50 IAC 21-3-3(b)(2009) ("The valuation date is January 1 of the year preceding the year of the assessment date.").

71. While the Assessor has the burden of proof in this appeal, both parties met their respective burdens of production by offering valuation opinions from qualified expert witnesses. Each party, of course, argued that its expert's data and methodology was more reliable and better supported than the opposing expert's data and methodology. The Board must therefore weigh the experts' opinions to determine the true tax value of Wesleyan's property.
72. The Board first notes that Lichtenberg and Bovee arrived at similar numbers in valuing the entire business enterprise (*i.e.*, the real estate, intangible business assets, and FF&E)—Bovee valued the entire enterprise at \$ [REDACTED] as of January 1, 2007, while Lichtenberg valued it at \$ [REDACTED] as of that date.
73. To the extent that the appraisers differed in their methodologies for valuing the business enterprise as a whole, the Board generally finds Bovee's opinion to be more credible. First, while both appraisers valued the property retrospectively, Bovee used information from around the January 1, 2007 valuation date. Lichtenberg, on the other hand, initially valued the property as of March 1, 2010, mostly using data from well after 2007, and trended his conclusions back to January 1, 2007. Bovee's opinion therefore more closely mirrors the likely decision-making of an informed investor both on the March 1, 2008 assessment date and the January 1, 2007 valuation date applicable to that assessment.

74. Similarly, Bovee largely provided more support for various subjective judgments underlying his valuation of the business as a whole than did Lichtenberg. For example, while both appraisers found wide ranges of sale prices under their respective sales-comparison analyses, Bovee offered a more detailed and reasoned comparison between Wesleyan's facility and his comparable sales. He also gave detailed explanations to support his adjustments to those sale prices, including adjustments for sales that were part of portfolio transactions. Lichtenberg did less to support his qualitative analysis. And he did little to explain his decision not to adjust the sale prices from his two comparable sales that were part of the same portfolio transaction. Instead, he simply indicated that the sale prices were buyer allocations. That does not mean that those allocated sale prices necessarily required an adjustment, but Lichtenberg's summary treatment of the issue does not inspire confidence.
75. The gulf between the two experts' opinions, however, stems mostly from how they valued the intangible assets, which in turn led them to allocate significantly different portions of Wesleyan's overall business value to real property. Bovee valued Wesleyan's assembled workforce and permits at \$ [REDACTED] and therefore assigned a significant portion of the entity's overall NOI to those costs, leaving a relatively modest amount to capitalize in determining the real property's value. Lichtenberg, by contrast, assigned only 15% of the business's overall NOI to intangible assets, leading him to allocate most of the facility's NOI to real estate and to value the intangible assets at only \$ [REDACTED].
76. The Board's decision is complicated by the fact that there appears to be no single generally accepted approach to allocating a business's overall value between tangible and intangible assets. The methodologies employed by Lichtenberg and Bovee both seem plausible. While Morlan and Bovee made much of the fact that Lichtenberg's entrepreneurial- or proprietary-profit capitalization approach is not universally accepted, Tellatin's book shows that at least some of the profession has accepted that methodology. Similarly, Bovee testified without impeachment or rebuttal that his methods for valuing Wesleyan's assembled workforce and permits are supported by USPAP Standards 9 and 10 and are used in valuing intangible assets in various types of legal proceedings.

77. Ultimately, the Board finds Bovee's allocation analysis to be the better reasoned and supported of the two. Lichtenberg simply deducted an estimated 15% of the overall NOI. Yet Lichtenberg did little to support why he chose that amount. He established a range of 10% to 20%, the low end of which he drew from his estimate of entrepreneurial incentive under his cost approach, and the high end of which he took from a seminar in which the authors apparently found that skilled nursing facilities typically rent for an amount between 80% and 85% of NOI. But Lichtenberg offered little or no support for his conclusions about entrepreneurial incentive. And he did not attempt to parse out the types of facilities on which the seminar's vague aggregate data was based. Lichtenberg then settled on the middle of that range, which happened to equal the *minimum* amount that HUD deducts for proprietary profit when making federally insured loans on nursing home real estate.
78. Granted, Lichtenberg's conclusions under the cost-approach, in which he directly estimated the real property's value, were generally consistent with his ultimate allocation of the business's overall value between real estate and other assets. But there are significant problems that detract from the reliability of Lichtenberg's cost-approach analysis. As already explained, Lichtenberg did not support his choice to include entrepreneurial incentive equaling 10% of hard costs. Also, as Morlan pointed out, Lichtenberg summarily dismissed the presence of any functional or external obsolescence. Morlan, however, persuasively explained that a building the age of Wesleyan's likely would have at least some functional obsolescence due to its lack of energy efficiency. Bovee, too, pointed out that the building was constructed in phases, with each phase creating a new plant design, duplicated interior and exterior walls, and new roof lines. And the Board is persuaded by Bovee's opinion that retrofitting costs related to such additions generally cannot be recaptured on a dollar-per-dollar basis. Similarly, Morlan laid out the external economic issues impacting nursing homes in cities affected by the decline in the automobile industry, casting some doubt on Lichtenberg's summary conclusion that the property did not suffer from any external obsolescence.

79. That is not to say that Bovee's allocation analysis was perfect. He made several assumptions in his relief-from-royalty analysis, most significantly in choosing hotel franchise rights to serve as a proxy for Wesleyan's licenses, permits and approvals. And he did not describe the licenses, permits and approvals at issue in any detail. Similarly, Bovee did little to support the capitalization rates that he used in determining what portions of the enterprise's overall NOI to attribute to intangible assets and FF&E, although the Board notes that his 25% rate for the intangible assets was the same rate that Lichtenberg used in his analysis. On the whole, though, the Board finds Bovee's allocation analysis to be better supported and more persuasive than Lichtenberg's analysis.

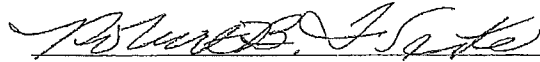
80. The Board therefore finds that the true tax value^{0.4.} of Wesleyan's property for the March 1, 2008 assessment was no more than \$3,006,100—the amount that Bovee estimated in his appraisal.⁷ In reaching this conclusion, the Board notes that Bovee appraised Wesleyan's entire property, not just the main parcel. But Wesleyan offered nothing that would allow the Board to allocate that value between parcels.

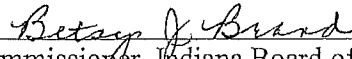
SUMMARY OF FINAL DETERMINATION

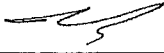
81. The Board finds for Wesleyan and orders that the March 1, 2008 assessment for the main parcel (27-07-18-302-190.000-002) be changed to \$3,006,100. The Board also grants Wesleyan's request to withdraw its appeal of the ancillary parcel (27-07-18-302-129.000-002).

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

⁷ Bovee actually estimated a value of \$3,006,060, but the Board rounds that estimate to the nearest \$100 increment. See 2002 REAL PROPERTY ASSESSMENT GUIDELINES, ch. 2 at 130 (incorporated by reference at 50 IAC 2.3-1-2)(instructing assessors to report assessed value "rounded to the nearest \$100")


Chairman, Indiana Board of Tax Review


Commissioner, Indiana Board of Tax Review


Commissioner, Indiana Board of Tax Review

IMPORTANT NOTICE

- APPEAL RIGHTS -

You may petition for judicial review of this final determination under the provisions of Indiana Code § 6-1.1-15-5, as amended effective July 1, 2007, by P.L. 219-2007, and the Indiana Tax Court's rules. To initiate a proceeding for judicial review you must take the action required within forty-five (45) days of the date of this notice. The Indiana Tax Court Rules are available on the Internet at <http://www.in.gov/judiciary/rules/tax/index.html>. The Indiana Code is available on the Internet at <http://www.in.gov/legislative/ic/code>. P.L. 219-2007 (SEA 287) is available on the Internet at <http://www.in.gov/legislative/bills/2007/SE/SE0287.1.html>.