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IN THE
INDIANA TAX COURT

BEDFORD APARTMENTS, An Indiana Limited Partnership,	)	
Petitioner,	)	
v.	)	Cause No. 49T10-0310-TA-51
TAMMIE HARRISON JEAN, in her official capacity as SHAWSWICK TOWNSHIP ASSESSOR, LAWRENCE COUNTY,	)	
Respondent.	)	

ON APPEAL FROM A FINAL DETERMINATION OF
THE INDIANA BOARD OF TAX REVIEW

NOT FOR PUBLICATION
April 27, 2006

FISHER, J.

Bedford Apartments, LP (Bedford) appeals the final determination of the Indiana Board of Tax Review (Indiana Board) valuing its property as of the March 1, 2001 assessment date. The sole issue for the Court to decide is whether the Indiana Board's final determination is erroneous because it failed to apply an economic obsolescence depreciation adjustment to Bedford's property.

FACTS AND PROCEDURAL HISTORY

Bedford owns a 56-unit apartment complex (the Complex) in Bedford, Indiana. The Complex, which was constructed in 2000, was designed as a low-income housing development in order to qualify for tax credits pursuant to section 42 of the Internal Revenue Code (the LIHTC Program).[1]

Under the LIHTC Program, Bedford is to receive approximately $2.5 million in tax credits to award to investors who provided financing for the project.[2] In exchange for these tax credits, Bedford agreed to rent all of its units to individuals or families who earn 60% or less of the area's median household income, with preference on three

[1] Federal law provides numerous tax incentives to encourage the production of affordable housing for low-income individuals, including the Low Income Housing Tax Credit (LIHTC) Program at issue here. *See, generally,* 26 U.S.C. § 42 (2006). The LIHTC Program authorizes individual states to issue federal income tax credits to developers as an incentive for the acquisition, rehabilitation, or new construction of affordable rental housing. In Indiana, this program is administered by the Indiana Housing Finance Authority (IHFA).

To qualify for LIHTCs, a project must reserve a portion of its rental units for use by low-income households, with rents on those units limited to a percentage of qualifying income. Furthermore, the use of the property is restricted by deed to low-income housing for at least fifteen years. In the event that a project does not comply with such restrictions, the credits are subject to recapture.

After the state allocates the tax credits to a project's developers, the credits are usually sold to private investors in a limited partnership. The money paid for the credits is used as equity financing to make up the difference between a project's development costs and the non-tax credit financing expected from rental income. In turn, the private investors are able to use the tax credits to offset their federal income tax liabilities, claiming the credits for each year of a ten-year period as long as the imposed rental restrictions are met. If a property eligible for § 42 credits is sold, the subsequent owner of the property is entitled to the future tax credits associated with the property.

[2] More specifically, Bedford is to receive $255,870 in tax credits per year for a period of ten years. (*See* Cert. Admin. R. at 237-38.)

units going to developmentally disabled tenants.[3] In addition, Bedford agreed to charge rents pursuant to guidelines established by the Indiana Housing Finance Authority (IHFA) and the Department of Housing and Urban Development (HUD). Pursuant to these guidelines, the Complex could charge between: 1) $333 and $536 per month for a one-bedroom unit; 2) $426 and $642 per month for a two-bedroom unit; and 3) $552 and $743 per month for a three-bedroom unit.[4] Bedford agreed to abide by these rental restrictions for a period of forty years.

On March 1, 2001, the Complex was assessed as new construction and valued at $1,553,300 ($36,600 for land and $1,516,700 for improvements).[5] Believing this value to be too high, Bedford appealed its assessment to the Lawrence County Property Tax Assessment Board of Appeals (PTABOA), alleging that the assessment failed to reflect that the Complex was suffering from economic obsolescence.[6] The PTABOA, however, denied Bedford's appeal.

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[3] In 1998, the area's median household income was $41,000.00. (*See* Cert. Admin. R. at 296.)

[4] Nevertheless, Bedford indicates that the Complex reduced these rates by approximately 25%, charging between: 1) $255 and $415 per month for a one-bedroom unit; 2) $310 and $435 per month for a two-bedroom unit; and 3) $430 and $525 per month for a three-bedroom unit. (Pet'r Proposed Findings of Fact and Conclusions of Law at 2, ¶ 8-9.)

[5] Construction on the Complex was completed in 2000; as of the March 1, 2001 assessment date, the Complex had been in operation for eight months.

[6] Indiana's assessment regulations define economic obsolescence as a loss of property value due to factors external to the property. *See* IND. ADMIN. CODE tit. 50, r. 2.2-10-7(e) (1996). Economic obsolescence may be caused, among other things, by the fact that an improvement is located in an inappropriate area, was constructed for a need that has subsequently been terminated due to actual or probable changes in economic or social conditions, or was constructed for the manufacture of a product which has subsequently suffered from decreased market acceptability. *See id.*

Bedford subsequently appealed its assessment to the Indiana Board. On September 15, 2003, after conducting an administrative hearing on the matter, the Indiana Board issued a final determination upholding the PTABOA's assessment of the Complex.

Bedford filed this original tax appeal on October 30, 2003. The Court heard the parties' oral arguments on September 10, 2004. Additional facts will be supplied as necessary.

STANDARD OF REVIEW

This Court gives great deference to final determinations of the Indiana Board. *Wittenberg Lutheran Vill. Endowment Corp. v. Lake County Prop. Tax Assessment Bd. of Appeals,* 782 N.E.2d 483, 486 (Ind. Tax Ct. 2003), *review denied*. Consequently, the Court will reverse a final determination of the Indiana Board only if it is:

> (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
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> (2) contrary to constitutional right, power, privilege, or immunity;
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> (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory jurisdiction, authority, or limitations;
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> (4) without observance of procedure required by law; or
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> (5) unsupported by substantial or reliable evidence.

IND. CODE ANN. § 33-26-6-6(e)(1) - (5) (West 2006).

DISCUSSION

When a taxpayer challenges an Indiana Board final determination, it bears the burden of demonstrating that the Indiana Board's determination is incorrect. *See Long* *v. Wayne Twp. Assessor,* 821 N.E.2d 466, 468 (Ind. Tax Ct. 2005), *review denied*. To meet this burden, the taxpayer must present a prima facie case, *i.e*., a case where the evidence is sufficient to establish a given fact and which, if not contradicted, will remain sufficient. *Id.*

In making a prima facie case for obsolescence, the taxpayer must make a two-pronged showing: first, it must identify the causes of the obsolescence, and second, it must quantify the amount of obsolescence to be applied. *See Clark v. State Bd. of Tax Comm'rs,* 694 N.E.2d 1230, 1241 (Ind. Tax Ct. 1998). Each of these prongs, however, requires a connection to an actual loss in property value. *See id.* at 1238. For example, when identifying causes of obsolescence, a taxpayer must provide probative evidence that identifies the existence of specific factors that are causing obsolescence in its improvement. *See id.* at 1239. In other words, the taxpayer must show how the causes of obsolescence it alleges to exist in its property are causing an actual loss of value.[7] *See Miller Structures, Inc. v. State Bd. of Tax Comm'rs*, 748 N.E.2d 943, 954 (Ind. Tax Ct. 2001) (footnote added). Only after this showing has been made does the taxpayer proceed to the second-prong: the quantification of obsolescence.[8]

When quantifying obsolescence, the taxpayer must convert its property's actual loss of value (as shown in the first prong) into a percentage reduction and then apply

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[7] In the commercial context, this loss of value usually means a decrease in a property's income-generating ability. *Miller Structures, Inc. v. State Bd. of Tax Comm'rs*, 748 N.E.2d 943, 953 (Ind. Tax Ct. 2001) (citation omitted).

[8] Indeed, "[w]here there is no cause of obsolescence, there is no obsolescence to quantify." *Lake County Trust Co. No. 1163 v. State Bd. of Tax Comm'rs,* 694 N.E.2d 1253, 1257 (Ind. Tax Ct. 1998), *review denied.*

that reduction against the improvement's true tax value.[9] *See Clark,* 694 N.E.2d at 1240 (footnote added). As a means of converting a property's loss in value into a percentage reduction, this Court has sanctioned the use of those generally recognized appraisal methods that are used to quantify obsolescence in market-value based jurisdictions.[10] *See id.* at 1242, n.18 (footnote added). *See also Lacy Diversified Indus., Ltd. v. Dep't of Local Gov't Fin.,* 799 N.E.2d 1215, 1224-25 (Ind. Tax Ct. 2003); *Inland Steel Co. v. State Bd. of Tax Comm'rs,* 739 N.E.2d 201, 211 (Ind. Tax Ct. 2000), *review denied*; *Canal Square Ltd. P'ship v. State Bd. of Tax Comm'rs,* 694 N.E.2d 801, 806-07 (Ind. Tax Ct. 1998); *Thorntown Tel. Co. v. State Bd. of Tax Comm'rs,* 588 N.E.2d 613, 619 (Ind. Tax Ct. 1992). One of the methods frequently used in cases before this Court is to determine a property's market value under both the income capitalization

[9] In 2001, property in Indiana was assessed on the basis of its "true tax value," a standard that bore no relation to a property's market value. *See* IND. CODE ANN. § 6-1.1-31-6(c) (West 2001) (amended 2002). *See also Dawkins v. State Bd. of Tax Comm'rs,* 659 N.E.2d 706, 709 (Ind. Tax Ct. 1995).

[10] Despite the fact that Indiana did not assess property on the basis of its market value during the year at issue, this Court has held that the methods used to quantify obsolescence in market-value based jurisdictions are just as applicable in quantifying obsolescence in Indiana, as Indiana's assessment regulations tied the definition of obsolescence to market value concepts. *See Canal Square Ltd. P'ship v. State Bd. of Tax Comm'rs,* 694 N.E.2d 801, 806, n.8 (Ind. Tax Ct. 1998).

approach[11] and the cost approach[12], and then convert the difference into an obsolescence percentage. *See, e.g., Lacy Diversified,* 799 N.E.2d at 1224; *Canal Square,* 694 N.E.2d at 806-87 (footnotes added).

At the administrative hearing in this case, Bedford introduced the testimony of expert witness Bonnie Mitchell, an appraiser certified as a Member of the Appraisal Institute (MAI), together with her appraisal[13] valuing the Complex as of March 1, 2001. In her appraisal, Mitchell identified the Complex's rental restrictions as the source of economic obsolescence. (Cert. Admin. R. at 129, 485.) (*See also* Cert. Admin. R. at 2 (Bedford's appeal form stating that the "[p]roperty suffers from economic obsolescence

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[11] Under the cost approach to market value, an appraiser estimates the cost to construct a reproduction of, or replacement for, the existing structure (typically through use of the Marshall & Swift Valuation Service cost index) and then deducts all accrued depreciation in the property. *Lacy Diversified Indus., Ltd. v. Dep't of Local Gov't Fin.,* 799 N.E.2d 1215, 1224 (Ind. Tax Ct. 2003).

[12] In applying the income capitalization approach,

> the income expected to be earned by the subject property is estimated, allowing for reasonable expenses, vacancy, and/or collection loss, to arrive at net operating income (NOI). The NOI is subsequently converted to a present value by dividing it by a capitalization rate. The capitalization rate generally reflects the annual rate of return necessary to attract investment capital and is influenced by such factors as apparent risk, market attitudes toward future inflation, the prospective rates of return for alternative investments, the rates of return earned by comparable properties in the past, the supply of and demand for mortgage funds, and the availability of tax shelters.

Id. (internal citation and quotation omitted).

[13] Mitchell certified that her appraisal was completed in conformance with both the Uniform Standards of Professional Appraisal Practice (USPAP) and the requirements of the Code of Professional Ethics and Standards of Professional Practice. (Cert. Admin. R. at 181.)

because of restricted rents”); Pet’r Br. at 2 (stating that the Complex’s “loss in value result[s] from . . . mandate[d] restricted rents[] that are below market”).) In turn, Bedford submitted financial statements indicating that, in both 2001 and 2002, the Complex did not generate a profit. (*See* Cert. Admin. R. at 323.) (*See also* Cert. Admin. R. at 597.)

Mitchell’s appraisal also quantified the amount of obsolescence present in the Complex at 36%.[14] In arriving at that quantification, Mitchell compared what she determined the Complex’s fair market value to be under the cost approach ($3,592,000)[15] with what she determined the Complex’s fair market value to be under the income capitalization approach ($322,000).[16] Mitchell converted the difference to a 36% obsolescence percentage reduction after she took into account the value of the

[14] On its face, Mitchell’s appraisal indicates that the Complex is entitled to a 57% obsolescence adjustment. (Cert. Admin. R. at 91, 177.) During the administrative hearing, Mitchell acknowledged that she made a mathematical error in her calculation, and that the proper adjustment should be 36%. (Cert. Admin. R. at 476.)

[15] In the case at bar, Mitchell determined that the total cost to construct a replacement Complex, pursuant to Marshall & Swift, was $3,140,675. (*See* Cert. Admin. R. at 130.) To that figure, Mitchell added the value of the appliances ($58,520) and a 15% entrepreneurial profit ($479,879) for a total of $3,679,074. (Cert. Admin. R. at 130.) Mitchell then deducted the amount of physical depreciation that the Complex had experienced ($176,099) to arrive at a final replacement cost (before obsolescence) of $3,502,975. (Cert. Admin. R. at 130.) Mitchell then added back $168,000 to account for the value of the land and $92,442 to account for the value of other “depreciated site improvements,” arriving at a final value of $3,760,000 (rounded). (Cert. Admin. R. at 130.) Mitchell then subtracted the land value for a final cost value of the improvements of $3,592,000. (*Cf.* Cert. Admin. R. at 130 *with* 177.)

[16] Here, Mitchell determined that the Complex’s actual gross income received in 2001 was $296,791. (Cert. Admin. R. at 175.) (*Cf. with* Cert. Admin. R. at 262-64, 323, 350.) She subsequently allowed for a 10% vacancy loss, and deducted actual operating expenses of $223,022, to arrive at a net operating income (NOI) of $44,090. (Cert. Admin. R. at 175.) (*Cf. with* Cert. Admin. R. at 323.) Mitchell then applied a capitalization rate of 9% to the Complex’s NOI, estimating that its fair market value was $490,000. (*See* Cert. Admin. R. at 175.) Mitchell then subtracted the value of the land ($168,000) for a total value of $322,000. (Cert. Admin. R. at 177.)

remaining tax credits on the project.[17] (*See* Cert. Admin. R. at 177 (footnote added).) *See also* fn. 14, *supra.*

Based on this evidence, Bedford contends that it made a prima facie case demonstrating that the Complex is entitled to obsolescence. (*See* Cert. Admin. at 485, 494 (Mitchell's testimony that "the difference between our cost and [income] value[s] proves [that obsolescence is present]" and that the difference is attributable to the rent restrictions).[18]) (*See also* Pet'r Br. at 19 (stating that it submitted a prima facie case by: "(i) establishing the fact that the rent restrictions depress the earning capacity of the [Complex] . . . and (ii) establishing, through probative evidence, including an Appraisal prepared in accordance with generally accepted appraisal methods by a competent

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[17] In other words, Mitchell took the difference between the cost approach and the income approach, reduced it by the value of the remaining tax credits on the project, and converted it to an obsolescence percentage reduction ($3,270,000 minus $1,968,229 equals $1,301,771; $1,301,771 divided by $3,592,000 equals 36%). The Court notes that Mitchell's appraisal provides no analysis as to how she valued the tax credits, except for the following statement: "[a]ccording to information provided by the ownership, the tax credits have been valued at $1,968,229." (Cert. Admin. R. at 177.) (*Cf. with* Cert. Admin. R. at 271 (statement from ownership that value of tax credits was $1,968,229).) Likewise, she provided no testimony during the administrative hearing regarding the computation of the tax credits' value. (*See* Cert. Admin. R. at 464-611.) *Cf. with Hometowne Assocs., L.P. v. James P. Maley, Jr., Twp. Assessor of Center Twp., Marion County,* 839 N.E.2d 269, 277 (Ind. Tax Ct. 2005) (where appraiser determined value of § 42 tax credits in two separate calculations).

[18] At this point during her testimony, Mitchell stated that she also attributed the difference between the Complex's cost and income approaches to "the lease-up period." (Cert. Admin. R. at 485.) When questioned on this point by opposing counsel, Mitchell merely stated "[t]he lease-up period as of March 2001 the property wasn't at a stabilized opportunity." (Cert. Admin. R. at 486.) This statement does little to elucidate how the Complex's lease-up period was a contributory cause of economic obsolescence, and the Court will not attempt to attach a meaning to it. *See Clark v. Dep't of Local Gov't Fin.*, 779 N.E.2d 1277, 1282 n. 4 (Ind. Tax Ct. 2002) (stating that a taxpayer has the "duty to walk the [Indiana Board and this] Court through every element of [its] analysis").

licensed appraiser showing that the [Complex] does not generate enough income, including the value of the tax credits, to justify its depreciated cost").) In its final determination, however, the Indiana Board concluded that Bedford had not made a prima facie case for obsolescence. The Indiana Board's conclusion is correct.

This Court has previously held that rental restrictions like the ones at issue in this case may very well cause economic obsolescence. *See Pedcor Investments-1990-XIII, L.P. v. State Bd. of Tax Comm'rs,* 715 N.E.2d 432, 437 (Ind. Tax Ct. 1999). Nevertheless, when a taxpayer alleges that such rental restrictions are the cause of obsolescence, the taxpayer must show *how* the rental restrictions hinder the subject property's ability to generate income. *See Miller Structures,* 748 N.E.2d at 953-54. This generally requires a comparison of some sort. In the context of § 42 housing, that comparison has typically been made to unrestricted rents in the market place. *See Pedcor,* 715 N.E.2d at 436, 437 (stating that deed restrictions mandating rents 13% to 20% below market rates affected the income-producing ability of an apartment complex and thus, its value). In this case, Bedford attempts a similar comparison: its appraisal states that "[t]he subject has [economic] obsolescence due to the fact that it is an LIHTC project. Because the subject's rents are lower than the market, it is faced with a loss in value." (Cert. Admin. R. at 129.) The evidence presented in this case, however, does not bear this comparison out.

Admittedly, the Complex's 2001 rental rates were lower than the rental rates at non-restricted apartment complexes in the area: while market rates averaged approximately $401 per month for a one-bedroom unit, $449 per month for a two-bedroom unit, and $588 per month for a three bedroom unit, the Complex charged between $255 and $415 per month for a one-bedroom unit, between $310 and $435 per month for a two-bedroom unit; and between $430 and $525 per month for a three-bedroom unit. (*See* Cert. Admin. R. at 168-70; Pet'r Proposed Findings of Fact and Conclusions of Law at 2, ¶ 8.) Nevertheless, the reason *why* the Complex charged lower rental rates was not because it was mandated to do so pursuant to the rental restrictions with the government; indeed, as indicated earlier, pursuant to IHFA/HUD's rental guidelines, the Complex was authorized to charge between $333 and $536 per month for a one-bedroom unit, between $426 and $642 per month for a two-bedroom unit, and between $552 and $743 per month for a three-bedroom unit. Rather, as Bedford acknowledges, the reason it charged lower than market rates was because "the [] market would not support rents at the maximum allowable amounts. Therefore, rents had to be reduced."[19] (Pet'r Br. at 7 (citation omitted) (footnote added).)

This evidence clearly demonstrates that the *rent restrictions themselves* did not hinder the Complex's ability to generate income.[20] Consequently, Bedford has not linked the alleged cause of the Complex's obsolescence of which it complains with an

[19] During oral argument, counsel for Bedford stated that "[i]t was the economic downturn of the area which resulted in . . . the property being [un]able to charge [the] maximum allowable rents[.]" (Oral Argument Tr. at 10.)

[20] In other words, the rent restrictions did not cause Bedford to reduce the rents as much as it did.

actual loss in property value resulting from that cause.[21] As such, Bedford has failed to establish the first prong in its case for obsolescence.

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[21] After thoroughly reviewing the administrative record, the Court finds it necessary to make the following points. First, this Court has held that 1) rental restrictions like the ones at issue in this case may cause economic obsolescence and 2) the use of generally accepted appraisal techniques may be used to quantify obsolescence. *Pedcor Investments-1990-XIII, L.P. v. State Bd. of Tax Comm'rs,* 715 N.E.2d 432, 437 (Ind. Tax Ct. 1999); *Canal Square,* 694 N.E.2d at 806-87. As evidenced in the presentation of its case, Bedford interprets these rulings to mean that if a taxpayer presents a certified appraisal which identifies a difference between the subject property's cost and income values (typically representing obsolescence) and the taxpayer participates in the LIHTC Program, it has necessarily made its prima facie case. (*See* Pet'r Br. at 9-10; Cert. Admin. at 485, 494 (Mitchell's testimony that "the difference between our cost and [income] value[s] proves [that obsolescence is present]" and the difference – *as a result* – is attributable to the rent restrictions).) This interpretation is erroneous because it allows Bedford to "back into" a prima facie case without actually linking the alleged cause of its obsolescence with a correlating loss in property value, as required by the holding in *Miller Structures.*

This leads the Court to its second point. Bedford has based its claim for obsolescence on its restricted rents. (*See* Cert. Admin. R. at 2, 129, 485; Pet'r Br. at 2.) In its reply brief filed with this Court, however, Bedford states that it "identified the causes of obsolescence as (i) having deed restrictions on the amount of rent that the property can charge as well as having restrictions on the income levels of tenants; (ii) having higher than usual turnover rates and bad debts; and (iii) being in the lease-up stage." (Pet'r Reply Br. at 2.) Admittedly, during the administrative hearing process, Bedford (through its expert witnesses) made several references to: 1) the difference between the Complex's cost and income approaches as being partially attributable to "the lease-up period"; 2) the Complex's relatively high expenses; and 3) the Complex's "very high turnover . . . [of] 43%" in 2001. (*See, e.g.,* Cert. Admin. R. at 485-86, 542, 596.) Bedford's counsel also made several similar references during oral argument before this Court. (*See* Oral Argument Tr. at 6-7, 10.)

Bedford apparently believes that from these references that it could be *inferred* that the Complex suffered from economic obsolescence. Inferences, however, do not a prima facie case make. *See Clark,* 779 N.E.2d at 1282 n.4 (stating that in making a prima facie case, the taxpayer must walk the Indiana Board through every element of its analysis). Consequently, if there are inferences to be made from the evidence, it was up to Bedford to walk the Indiana Board through its reasoning and to point the Indiana Board, with specific citation, to the evidence that supported its reasoning; neither the Indiana Board nor this Court will make Bedford's case for it. Because the record in this case is devoid of any explanation linking the Complex's high turnover rate, bad debts, and lease-up stage with its claim for obsolescence, Bedford's inferences carry no probative value.

CONCLUSION

Bedford has not made a prima facie case that the Complex is entitled to an economic obsolescence adjustment for the 2001 tax year. Accordingly, the Indiana Board's final determination is AFFIRMED.