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**IN THE
INDIANA TAX COURT**

JAMES K. JOHNSTON and)	
JACQUELINE JOHNSTON,)	
)	
Petitioners,)	
)	
v.)	Cause No. 82T10-0206-TA-80
)	
JOHN GERARD, CENTER TOWNSHIP)	
ASSESSOR, VANDERBURGH COUNTY,)	
)	
Respondent.)	
)	

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

NOT FOR PUBLICATION

January 17, 2007

FISHER, J.

James K. Johnston and Jacqueline Johnston (the Johnstons) appeal the final determination of the Indiana Board of Tax Review (Indiana Board) valuing their real property for the 1996 and 1997 tax years (years at issue). The issue for the Court to decide is whether the Indiana Board erred in denying the Johnstons' apartment complex a 67.5% obsolescence depreciation adjustment.

FACTS AND PROCEDURAL HISTORY

The Johnstons own an apartment complex (Northwoods) in Evansville, Indiana. When the Johnstons purchased Northwoods, it consisted of twelve apartment buildings constructed between 1979 and 1993. In 1996, the Johnstons constructed another building in the Northwoods complex. After doing so, however, the Johnstons discovered that their property was experiencing excessive settling due to a defect in the property's site preparation when the buildings were originally constructed. More specifically, when the site was leveled in order to lay the buildings' foundations, it was filled with debris, soil, and trees. Because the fill was not properly drained and compacted, the trees and debris have since decayed and rotted. This, in turn, has caused the fill to become very soft and collapse; likewise, the foundations are collapsing.

For the years at issue, the Center Township Assessor (Assessor) assigned Northwoods an assessed value of \$452,330 (\$24,600 for the land and \$427,730 for the improvements). In doing so, he applied a 5% obsolescence adjustment. Believing the improvements assessment was too high, the Johnstons appealed the 1996 and 1997 assessments to the Vanderburgh County Board of Review (BOR), requesting among other things, a twenty-five percent (25%) obsolescence depreciation adjustment. The BOR, however, upheld the Assessor's original 5% obsolescence adjustment.

The Johnstons then appealed to the State Board of Tax Commissioners (State Board). The State Board held a hearing on May 17, 2001, during which the Johnstons

requested a 67.5% obsolescence adjustment. On May 14, 2002, the Indiana Board issued a final determination denying the request.¹

The Johnstons initiated an original tax appeal on June 26, 2002. The Court heard the parties' oral arguments on May 2, 2003. Additional facts will be supplied as necessary.

ANALYSIS AND OPINION

Standard of Review

This Court gives great deference to final determinations of the Indiana Board when it acts within the scope of its authority. *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;
- (2) contrary to constitutional right, power, privilege, or immunity;
- (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory jurisdiction, authority, or limitations;
- (4) without observance of procedure required by law; or
- (5) unsupported by substantial or reliable evidence.

IND. CODE ANN. § 33-26-6-6(e)(1)-(5) (West 2007).

¹ The legislature abolished the State Board of Tax Commissioners (State Board) as of December 31, 2001. See 2001 Ind. Acts 198 § 119(b)(2). Effective January 1, 2002, the legislature created the Indiana Board of Tax Review (Indiana Board). IND. CODE ANN. § 6-1.5-1-3 (West 2007); 2001 Ind. Acts 198 § 95. While the State Board drafted findings and conclusions in this case, it did not issue a final determination before December 31, 2001. The Indiana Board subsequently adopted the State Board's findings and issued a corresponding final determination on May 14, 2002. (See Cert. Admin. R. at 75-77.)

The party seeking to overturn the Indiana Board's final determination bears the burden of proving its invalidity. *Osolo Twp. Assessor v. Elkhart Maple Lane Assocs., L.P.*, 789 N.E.2d 109, 111 (Ind. Tax Ct. 2003). In order to meet that burden, the party seeking reversal must have submitted, during the administrative hearing process, probative evidence regarding the alleged assessment error. *Id.* (footnote omitted). If that party meets its burden of proof and prima facie establishes that the Indiana Board's final determination is erroneous, the burden then shifts to the opposing party to rebut the challenging party's evidence. See *Meridian Towers E. & W. v. Washington Twp. Assessor*, 805 N.E.2d 475, 479 (Ind. Tax Ct. 2003).

Discussion

"Obsolescence, which is a form of depreciation, is defined as a loss of [property] value and classified as either functional or economic." *Freudenberg-NOK Gen. P'ship v. State Bd. of Tax Comm'rs*, 715 N.E.2d 1026, 1029 (Ind. Tax Ct. 1999), *review denied*. See also 50 IND. ADMIN. CODE 2.2-10-7(e) (1996) (repealed 2002). Economic obsolescence is caused by factors external to the property. 50 I.A.C. 2.2-10-7(e). Functional obsolescence, however, is either a physical element that buyers are unwilling to pay for or a deficiency that impairs the utility of a property when compared to a more modern replacement, leading to a loss in value. *Freudenberg-NOK*, 715 N.E.2d at 1029 (citation omitted). It is caused by factors internal to the property and is evidenced by conditions within the property. *Pedcor Invs. v. State Bd. of Tax Comm'rs*, 715 N.E.2d 432, 435 (Ind. Tax Ct. 1999) (citations omitted). Functional obsolescence may be due to an irregular or inefficient floor plan, inadequate or unsuited utility space, or an excessive or deficient load capacity. 50 I.A.C. 2.2-10-7(e).

To establish a claim for obsolescence, a taxpayer must make a two-pronged showing: 1) it must identify the causes of the alleged obsolescence; and 2) it must quantify the amount of obsolescence to be applied to its improvement(s). See *Clark v. State Bd. of Tax Comm'rs*, 694 N.E.2d 1230, 1238, 1241 (Ind. Tax Ct. 1998). Each of these prongs, however, requires a connection to an actual loss in property value. *Id.* at 1238. For example, when identifying factors that cause obsolescence, a taxpayer must show through the use of probative evidence that those causes of obsolescence are causing an actual loss of value to its property. See *Miller Structures, Inc. v. State Bd. of Tax Comm'rs*, 748 N.E.2d 943, 954 (Ind. Tax Ct. 2001). In turn, when the taxpayer quantifies the amount of obsolescence to which it believes it is entitled, it is required to convert that actual loss of value (shown in the first prong) into a percentage reduction and apply it against the improvement's overall value. See *Clark*, 694 N.E.2d at 1238.

The Johnstons contend that their property is entitled to a 67.5% functional obsolescence adjustment because defective site preparation has resulted in unsupported foundations and massive settling, all of which require a rather large capital investment to prevent the complex from becoming uninhabitable. To support their claim, the Johnstons first presented a documented study and the testimony of Mr. Kent Lautner, a geotechnical engineer.

Mr. Lautner conducted a geotechnical engineering investigation of the subject property. (See Cert. Admin. R. at 150-168; 300-319.) In doing so, Mr. Lautner drilled three random borings fifteen and one-half (15.5) feet below the surface area to determine the subsurface conditions. (See Cert. Admin. R. at 150-168.) At boring locations one and two, the subsurface conditions varied from "very loose, loose, wet to

very soft” until approximately nine feet below ground where the ground became “medium stiff.” (See Cert. Admin. R. at 162-163.) At the third boring location, the conditions were described as “very soft, soft or wet” down to the bottom of the boring (i.e., at 15.5 feet). (See Cert. Admin. R. at 164.) After conducting a series of tests,² Mr. Lautner found that there was “[v]ery soft soil underneath the parking lot, subgrade, and under the building pads[,]” and that “[s]oil with strength consistencies as soft as these is not suitable to support foundation and slab loads without experiencing unacceptable settlement.” (Cert. Admin. R. at 157, 307.)

At the administrative hearing, Mr. Lautner testified:

the soil is soft for two reasons, one it was improperly placed fill at one time, assuming just prior to construction and two, the soil along the east side of the property is all low lying land. . . . The area on the west end is a higher level area and more than likely they had cut a hill and then pushed down in the low lying area and filled it. Swamp ground is basically, what you had down here at one time. . . . [T]he site [was] poorly prepped prior to [the] construction of [the] buildings.

(See Cert. Admin. R. at 308-309.) Mr. Lautner opined that at least eighty percent (80%) of the property suffered from the same soil conditions. (See Cert. Admin. R. at 312.) Mr. Lautner stated that the most economical stabilization method to cure the problem at Northwoods is to install a “mini-pile” system, which means:

excavat[ing] down along side the buildings, down to below the footings and then push small pipes usually about 3” diameter by 30” long, each set is about 30” long. They will push and keep pushing until they hit firma terra, which is rock. To do that on this type of building, I would probably put one about every 10’ all the way around the building. Then once they are all in place, they will rigidly attach these piles

² Mr. Lautner conducted a standard penetration test, an unconfined compressive strength test, and a natural moisture content test. (See Cert. Admin. R. at 155-157; 162-166.)

to the foundation with an angle bracket and then when the building has settled to the point where you want to level the building, like hydraulic jacks on these you can actually raise the building up, and then they would pour concrete, filling the void between the bottom of the footing and the soil[, or] . . . they can just rigidly attach the piles to the footings at that point, and that will keep the buildings from settling any more. . . . This is very time consuming and extremely expensive.

(Cert. Admin. R. at 314-316.)

Next, the Johnstons presented an estimate for the cost of the “mini-pile” system prepared by Mr. Jerry Brandenberger, an estimator, project manager and vice-president of Arc Construction Company. (See Cert. Admin. R. at 169-171; 319-320.) Mr. Brandenberger has experience installing the “mini-pile” system Mr. Lautner recommended for Northwoods. (Cert. Admin. R. at 322.) After examining the property and Mr. Lautner’s report, Mr. Brandenberger concluded that twelve of the buildings needed the system and the cost to install the system would be approximately \$936,000.³ (See Cert. Admin. R. at 323-325 (footnote added).) In arriving at that estimate, Mr. Brandenberger noted that it was “very conservative” and did not include any remedial repairs that would be required after installation. (Cert. Admin. R. at 325.)

Finally, the Johnstons presented an appraisal of the property completed by Mr. D. Stephen Parker, a licensed general appraiser. (Cert. Admin. R. at 172-206.) The appraisal incorporated the geotechnical investigation and the estimated cost to cure the property. Mr. Parker concluded that the poor site preparation of the property was

³ Mr. Brandenberger’s estimate of \$936,000 was dated November 13, 2000. (See Cert. Admin. R. at 169-170.) He also provided an estimate which, through the use of the Mean’s Building Construction Cost Data Index, adjusted this figure to the 1996 price of \$858,928. (See Cert. Admin. R. at 171; 326-327.)

functional obsolescence, which causes severe physical depreciation,⁴ and that “[t]he buildings simply [cannot] function as they were designed.” (Cert. Admin. R. at 177; 333-334 (footnote added).) Indeed, Mr. Parker testified:

[t]ypically, [expenses would run] between \$250 to \$300 a unit on repairs, [but with] the Johnstons’ property, they are looking at \$450 a unit on their repairs today, and there have been other years where it has been greater than that.

⁴ More specifically, in his appraisal, Mr. Parker stated:

[i]t appears that when the apartments were constructed [] the site was not properly prepared. The discovery of decayed wood and collapsing pockets of soft dirt or wet caves caused the physical problems such as cracks in [the] foundation, window and window casement replacement, [and] door and door casement replacement. Balconies have been removed due to rot and some have simply started to drop or fall off the building. Large holes have appeared in the asphalt where the ground has settled. Three buildings show evidence of cracking that can be attributed to the poor site preparation. . . . The buildings will continue to deteriorate over time as the site settles. At some point in time the buildings at the southwest and southeast corner of the site will not be habitable. Evidence is beginning to develop that Building ‘J’ and [B]uilding ‘R’ located on the northwest corner of the site are settling. Windows in all buildings are difficult to open and when closed leave air leaks. Some doors in all buildings are beginning to demonstrate that the buildings are shifting.

(Cert. Admin. R. at 177.) Mr. Parker also testified that within less than a year’s time, one of the apartment buildings had moved an inch due to the excessive settling. (See Cert. Admin. R. at 334-335.) Mrs. Jacqueline Johnston also testified as to the types of damages that occur at Northwoods:

we have had to replace balconies off the back because doors weren’t shutting properly and putting windows in. . . . Stairs have to be replaced because they are starting to get in a bind and twist and they were steel and concrete and the concrete was popping and the steel was pulling away from the landings upstairs. We have already once resurfaced the parking lots with asphalt but it is already giving in again.

(Cert. Admin R. at 348-349.)

Overall expenses on a typical property like this, should run between 38% and 42%, theirs is running greater than that, almost 50% from time to time, which bears out that they are repairing their property, but because their property is not functioning the way it is supposed to, they are having to put a ton of money into it to keep it where it is habitable.⁵

(Cert. Admin. R. at 339 (footnote added).) Mr. Parker also suggested that the defect causes a loss in value because it decreases the property's marketability. Specifically, Mr. Parker stated that a buyer would not be willing to purchase the property given its defect; at the very least, the purchase price would have to be reduced by the value of the cost to cure the problem. (See Cert. Admin. R. at 177; 345-346.)

Accordingly, Mr. Parker quantified the amount of obsolescence by using a cost to cure method. (See Cert. Admin. R. at 182; 341-345.) More specifically, Mr. Parker took the cost of the existing improvements as determined by the Marshall and Swift Valuation Handbook (\$1,981,540) less the estimated physical depreciation of all buildings (30%, or \$594,462) to arrive at the value after physical depreciation (\$1,387,078). (See Cert. Admin. R. at 182; 341-342.) Mr. Parker then divided Mr.

⁵ To further illustrate that point, Mrs. Johnston explained at the administrative hearing that she and her sister perform most of the repairs to the property in order to keep expenses down. (See Cert. Admin. R. at 340.) The Johnstons also submitted a copy of their 2000 tax return Schedule E, indicating that they incurred \$49,695 in repair expenses for that year. (See Cert. Admin. R. at 207-208; 340.) The Court notes, however, that repair expenses from 2000 do not establish the expenses paid in 1996.

Brandenberger's estimated cost to cure the functional obsolescence (\$936,000)⁶ by the value after physical depreciation (\$1,387,078) to arrive at a 67.5% obsolescence depreciation adjustment. (See Cert. Admin. R. at 182; 341-342 (footnote added).)

In its final determination, the Indiana Board held that the Johnstons "failed to establish additional functional obsolescence [] present in the buildings, as required by the first prong of the two-prong test articulated in *Clark*." (Cert. Admin. R. at 93.) In other words, the Indiana Board concluded that the Johnstons did not establish the cause of functional obsolescence, reasoning that deficiency of the property is external to the improvements (i.e., part of the land) and, therefore, is not functional obsolescence, by definition. (See Cert. Admin. R. at 91-92 (*citing* 50 IND. ADMIN. CODE 2.2-1-29 (1996) (repealed 2002) (defining functional obsolescence as obsolescence caused by factors inherent in the property itself)).)

The Indiana Board also concluded that the Johnstons' quantification "fail[ed] to conform to generally accepted standards of assessment and appraisal practice" because the cost to cure estimate "included expenses for the complete excavation and backfill to [the] bottom of [the] footing for each pier." (See Cert. Admin. R. at 94 (internal quotation omitted).) The Indiana Board concluded, without authority and in contravention of 50 I.A.C. 2.2-10-6.1 and 2.2-15-1, that it was "inappropriate to include

⁶ Mr. Parker also quantified the obsolescence using the 1996 estimate for the cost to cure by using the same method but merely substituting the 2000 estimate (\$936,000) with the 1996 estimate (\$858,928). By doing so, the obsolescence factor decreased from 67.5% to 61.9%. (See Cert. Admin. R. at 343-344.) Mr. Parker stated that the use of the 2000 estimate was appropriate in quantifying obsolescence because the property suffers from an "ongoing problem that has occurred over time." (See Cert. Admin. R. at 343.) Therefore, he stated "[i]t is not necessarily reasonable to go back to 1996 to cure the problem." (Cert. Admin. R. at 343.) Nevertheless, because the relevant tax year in this case is 1996 and not 2000, the Court will accept the 1996 quantification of 61.9%.

site preparation costs . . . in a calculation purporting to quantify functional obsolescence in improvements[,]” because obsolescence applies only to improvements, not to land. (See Cert. Admin. R. at 94.) The Indiana Board’s conclusions, however, are incorrect.

Indeed, site preparation, per Indiana’s assessment regulations, is priced as part of an improvement. See 50 IND. ADMIN. CODE 2.2-10-6.1(a)(3)(A) (1996) (repealed 2002) (stating that the first floor level price of an improvement includes “[s]ite preparation and normal foundation construction for a building at grade level”). Moreover, the regulations that provide unit-in-place cost schedules to aid in computing the reproduction cost of an improvement include costs for “sitework,” such as site grading - cut and fill, bulk excavation, trenching and footing excavation, material disposal, bulk fill, site grading and leveling. See 50 IND. ADMIN. CODE 2.2-15-1 (1996) (repealed 2001).

The Indiana Board also rejected the Johnstons’ quantification because the cost to cure was not based on a firm quote. (Cert. Admin. R. at 94.) Specifically, in Mr. Brandenberger’s estimate of the cost to cure, he stated that he would consider the estimate as a “ball park or budget” estimate and that there were several unknown factors which prevented him from making a firm quote. (Cert. Admin. R. at 169.) Nevertheless, Mr. Brandenberger testified that based on the amount of work that needed to be done, the estimate was, in fact, “very conservative.” (See Cert. Admin. R. at 325.) Furthermore, while the written estimate stated that the quote was a ballpark estimate, it also stated that the price did not include remedial work to apartments and buildings that may be necessary after installation. (Cert. Admin. R. at 169.) The

Indiana Board, however, chose to ignore that evidence.⁷ See *Canal Square Ltd. P'ship v. State Bd. of Tax Comm'rs*, 694 N.E.2d 801, 805 (Ind. Tax Ct. 1998) (explaining that the State Board cannot simply ignore a taxpayer's evidence; rather when a taxpayer offers probative evidence, that evidence must be dealt with in some meaningful manner) (footnote added).

Because the Johnstons presented probative evidence establishing that their property suffered from functional obsolescence and a calculation quantifying that obsolescence, they made a prima facie showing that their property was entitled to the 61.9% functional obsolescence depreciation adjustment. Therefore, the burden shifted to the opposing party to rebut the Johnstons' evidence. See *Meridian Towers*, 805 N.E.2d at 479. In a post-hearing brief submitted by the Vanderburgh County Assessor, the County Assessor stated, "[w]hile it is agreed that the evidence submitted [at the administrative hearing] for this apartment complex supports a diminished value, the taxpayer's request for 67.5% functional obsolescence is not warranted." (Cert. Admin. R. at 289.) Nevertheless, the County Assessor failed to introduce any evidence or alternate quantification calculations to contradict the Johnstons' prima facie case. (Cert. Admin. R. at 289-291.) Accordingly, the additional obsolescence depreciation must be granted.

⁷ The Indiana Board also noted that the Johnstons "failed to explain the reason that only one estimate was obtained in an attempt to establish a claimed cost to cure." (Cert. Admin. R. at 94.) The Indiana Board did not support this conclusion with any authority suggesting that more than one estimate was required nor did it elaborate as to how many estimates should have been presented. See *Canal Square Ltd. P'ship v. State Bd. of Tax Comm'rs*, 694 N.E.2d 801, 805 (Ind. Tax Ct. 1998) (stating that a determination based on unsupported conclusions or findings is arbitrary and will be reversed).

CONCLUSION

Because the Indiana Board's determination was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law, the Court now REVERSES the Indiana Board's final determination. See A.I.C. § 33-26-6-6(e). The Court hereby REMANDS the matter to the Indiana Board to instruct the Assessor to apply a 61.9% obsolescence adjustment to the Johnstons' assessment consistent with this opinion.