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IN THE
INDIANA TAX COURT

LAFAYETTE HOUSING ASSOCIATES, L.P., An Indiana Limited Partnership, and LAFAYETTE HOUSING ASSOCIATES II, L.P., An Indiana Limited Partnership, Petitioners, v. NANCY MOORE, WEA TOWNSHIP ASSESSOR, TIPPECANOE COUNTY, Respondent.	)	Cause No. 49T10-0206-TA-69

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

NOT FOR PUBLICATION
November 6, 2006

FISHER, J.

Lafayette Housing Associates, L.P. and Lafayette Housing Associates II, L.P. (collectively, LHA) appeal from a final determination of the Indiana Board of Tax Review (Indiana Board) valuing their real property for the 2000 assessment year (the year at issue). The sole issue for the Court to decide is whether the Indiana Board erred in denying an obsolescence depreciation adjustment to LHA's apartment complex for the year at issue.

FACTS AND PROCEDURAL HISTORY

LHA owns Bradford Place Apartments (hereinafter, the Complex), a low-income housing development in Lafayette, Indiana. The development consists of 120 rental units, each with one, two, or three bedrooms.

The Complex, constructed in two phases in the early 1990s, was designed as low-income housing in order to qualify for tax credits pursuant to section 42 of the Internal Revenue Code (the LIHTC Program).[1] Under this program, LHA received approximately $4.0 million in tax credits to award to investors who provided financing for the project. In exchange for these tax credits, LHA agreed to rent all 120 units to individuals whose income was 60% or less of the area's median gross income (adjusted

[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 (2005). 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 only, 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.

for family size). In addition, LHA agreed to charge rents pursuant to Indiana Housing Finance Authority (IHFA) guidelines. Pursuant to these guidelines, LHA was authorized to charge $579 per month for a one-bedroom unit; $683 per month for a two-bedroom unit; and $779 per month for a three-bedroom unit.[2] (*See* Cert. Admin. R. at 315 (footnote added).) LHA agreed to abide by these rental restrictions for a period of 15 years.[3]

For the 2000 assessment, the Tippecanoe County Property Tax Assessment Board of Appeals (PTABOA) assigned the Complex an assessed value of $969,440. (*See* Cert. Admin. R. at 160.) Believing this value to be too high, LHA appealed the PTABOA's valuation to the State Board of Tax Commissioners (State Board), alleging that the PTABOA failed to recognize that the Complex was suffering from obsolescence.

On June 7, 2001, the State Board conducted an administrative hearing on the matter. On April 25, 2002, the Indiana Board issued a final determination upholding the

[2] Nevertheless, LHA indicated that it reduced these rates by approximately 24%, charging $440 per month for a one-bedroom unit; between $500 and $570 per month for a two-bedroom unit; and between $613 and $675 per month for a three-bedroom unit. (Pet'r Findings of Fact and Conclusions of Law at 2, ¶¶ 8-10.)

[3] LHA states that it agreed to these restrictions for a period of 30 years. (*See* Pet'r Br. at 6 (*citing* Cert. Admin. R. at 462).) The administrative record, however, indicates that it agreed to the restrictions for a period of 15 years. (*See* Cert. Admin. R. at 462.)

PTABOA's assessment.[4]

LHA filed this original tax appeal on June 7, 2002.[5] The Court heard the parties' oral arguments on June 6, 2003. 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 may only reverse a final determination of the Indiana Board 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).

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[4] On December 31, 2001, the legislature abolished the State Board of Tax Commissioners (State Board). 2001 Ind. Acts 198 § 119(b)(2). Effective January 1, 2002, the legislature created the Indiana Board of Tax Review (Indiana Board) as "successor" to the State Board. IND. CODE ANN. §§ 6-1.5-1-3; 6-1.5-4-1 (West 2006); 2001 Ind. Acts 198 § 95. Consequently, when a final determination was issued on LHA's appeal in April of 2002, it was issued by the Indiana Board.

[5] As mentioned earlier, the Complex was built in two phases. In its initial filing with this Court, LHA filed an appeal with respect to Phase I as well as Phase II. By order dated September 26, 2002, this Court consolidated the two appeals under the above-captioned cause number.

DISCUSSION

In 2000, real property in Indiana was assessed on the basis of its "true tax value." IND. CODE ANN. § 6-1.1-31-6(c) (West 2000). A property's true tax value was not its fair market value, but rather the value as determined under Indiana's own assessment regulations. *See id.*

Under these assessment regulations, a commercial improvement's true tax value was equal to its reproduction cost less any physical and/or obsolescence depreciation present therein. *See* IND. ADMIN. CODE tit. 50, r. 2.2-10-7(f) (1996). Reproduction cost was defined as the "whole-dollar cost of reproducing the item." IND. ADMIN. CODE tit. 50, r. 2.2-10-5(d)(13) (1996). Nevertheless, the reproduction cost of an improvement was not the *actual* cost of reproducing the item but rather the cost as specified in the assessment regulations. *See* IND. ADMIN. CODE tit. 50, r. 2.2-10-6.1 (1996); IND. ADMIN. CODE tit. 50, r. 2.2-11-5.1 (1996); IND. ADMIN. CODE tit. 50, r. 2.2-11-6 (1996).

In turn, the assessment regulations defined obsolescence depreciation as either the functional or economic loss of value to a property. 50 IAC 2.2-10-7(e). For instance, functional obsolescence (or a loss of value resulting from factors internal to the property) could be caused by the fact that an improvement had limited use due to an irregular or inefficient floor plan, inadequate or unsuited utility space, or an excessive/deficient load capacity. *See id.* In contrast, economic obsolescence (or a loss of value resulting from factors external to the property) could be caused by the fact that an improvement was located in an inappropriate area, subject to inoperative or inadequate zoning ordinances or deed restrictions, constructed for a need which has subsequently been terminated due to actual or probable changes in economic or social conditions, or the manufacture of the product for which the improvement was originally constructed has suffered from decreased market acceptability. *Id.*

While the assessment regulations explained that obsolescence depreciation was to be applied as a percentage reduction (ranging from 0% to 95%) against an improvement's reproduction cost, they provided no explanation as to how to calculate how much obsolescence was actually present in an improvement. Nevertheless, this Court has held that because the assessment regulations tied the definition of obsolescence directly to that as applied by professional appraisers in calculating a property's fair market value, obsolescence under the true tax value system necessarily incorporated 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). Consequently, the Court has accepted the use of generally recognized appraisal methods for quantifying obsolescence as a permissible means of quantifying obsolescence under the true tax value system. *See Clark v. State Bd. of Tax Comm'rs,* 694 N.E.2d 1230, 1242 n.18 (Ind. Tax Ct. 1998). *See also Lacy Diversified Indus., Ltd. v. Dep't of Local Gov't Fin.,* 799 N.E.2d 1215, 1223 (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,* 694 N.E.2d at 806-87; *Thorntown Tel. Co. v. State Bd. of Tax Comm'rs,* 588 N.E.2d 613, 619 (Ind. Tax Ct. 1992).

When a taxpayer seeks an obsolescence adjustment, it is required to 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,* 694 N.E.2d at 1238. Each of these prongs, however, requires a connection to an actual loss in property value. 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. *Id.* In other words, the taxpayer *must show how* these factors 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 the commercial context, this loss of value usually means a decrease in the property's income-generating ability. *See id.* at 953. Only after this showing has been made does the taxpayer proceed to the second-prong: the quantification of obsolescence.[6] This prong requires the taxpayer to convert the actual loss of value (shown in the first prong) into a percentage reduction and apply it against the improvement's overall true tax value. *See Lacy Diversified,* 799 N.E.2d at 1223.

At the administrative hearing, LHA first presented the testimony of Kerry Brewer, regional manager of Buckingham Companies (the Complex's management company). Ms. Brewer explained that several factors were negatively impacting the Complex's ability to generate income:

> *<u>Higher than Normal Vacancy Rates</u>*: the Complex's average vacancy rate is approximately 15%.
>
> *<u>High Operating Costs</u>*: because the "clientele is a little less financially stable[and] a little more harsh on the apartments[,]" the Complex incurs higher operating costs in repairing damages to apartments and in legal fees. In addition, the Complex incurs higher administrative costs in not only ensuring that tenants actually qualify for placement in the Complex, but in providing them, once they are tenants, with certain types of services.

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

> *Restricted Rents*: Due to the restrictions on the amount of rent it can charge for its apartments, the Complex is unable to meet, or offset, its expenses.

(*See* Cert. Admin. at 481-83, 488-89, 496-97, 499-505, 510-12, 521.) (*See also* Cert. Admin. R. at 4 (LHA's appeal form stating that "[b]ased on vacancies, restricted rents, and higher operating, maintenance and construction costs, the [C]omplex is entitled to an obsolescence adjustment"); Oral Argument Tr. at 15-16.)

Next, LHA presented the testimony of Bonnie Mitchell, an appraiser certified as a Member of the Appraisal Institute (MAI), together with her appraisal[7] valuing the Complex as of March 1, 2000. In her appraisal, Mitchell quantified the amount of obsolescence present in the Complex at approximately 44%.[8] In arriving at that quantification, Mitchell compared what she determined the Complex's 2000 fair market value to be under the cost approach ($6,285,779)[9] with what she determined the Complex's fair market value to be under the income capitalization approach

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[7] Ms. 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 386, 408.)

[8] As indicated earlier, the Complex was developed in two phases. LHA specifically seeks a 46% obsolescence adjustment on Phase I and a 40% obsolescence adjustment on Phase II. (Cert. Admin. R. at 385, 407.)

[9] In the case at bar, Mitchell determined that the total cost to construct the Complex (in its two Phases in 1991 and 1993) was $5,420,763. (*See* Cert. Admin. R. at 383, 405.) Mitchell then deducted the cost of the land ($335,000) to arrive at a value of $5,085,763. (*See* Cert. Admin. R. at 383, 405.) Mitchell then applied a multiplier (to trend the number to a 2000 value) and deducted physical depreciation to arrive at a final cost value of the improvements of $6,285,779. (*See* Cert. Admin. R. at 383, 405.)

($3,500,000).[10] (See Cert. Admin. R. at 385, 407 (footnotes added).) Mitchell converted the difference to a 43% obsolescence percentage reduction.[11] (*See* Cert. Admin. R. at 385, 407 (footnote added).)

Based on this evidence, LHA contends that it made a prima facie case demonstrating that the Complex is entitled to obsolescence. (*See* Pet'r Br. at 14-15 (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 . . . [an] Appraisal[] prepared in accordance with generally accepted appraisal methods by a competent licensed appraiser . . . that the [Complex] does not generate enough income, including the value of the tax credits, to justify its depreciated cost").) (*See also* Pet'r Reply Br. at 3-4 (asserting that it met the first prong of obsolescence by showing that the Complex "[is] subject to rent restrictions . . . which do not allow rents to be generated sufficiently enough to justify the cost of the improvements" and that this

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[10] Here, Mitchell determined that the Complex's actual gross income received in 2000 was $736,840. (*See* Cert. Admin. R. at 384, 406.) She subsequently allowed for a 10% vacancy loss, and deducted 1999's actual expenses of $370,438 to arrive at a net operating income (NOI) of $292,718. (*See* Cert. Admin. R. at 384, 406.) Mitchell then applied a capitalization rate of 10% to the Complex's NOI and subtracted the value of the land. (*See* Cert. Admin. R. at 384, 406.) Finally, Mitchell added back the value of the remaining, unused tax credits ($918,871) for a total value of $3,500,000. (See Cert. Admin. R. at 384, 406.)

[11] In other words, Mitchell took the difference between the cost approach and the income approach and converted it to an obsolescence percentage reduction ($6,285,779 minus $3,500,000 equals $2,785,779; $2,785,779 divided by $6,285,779 equals 44%). The Court notes that Mitchell's appraisal provides no analysis as to how she valued the tax credits; rather, it appears she merely used numbers given to her from the Complex. (*See* Cert. Admin. R. at 383-84, 405-06; *cf. with* Cert. Admin. R. at 422 (statement from ownership that value of remaining tax credits was $918,871).) *But see 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 actually determined value of § 42 tax credits in two separate calculations).

cause of obsolescence was established by its submission of financial statements and an appraisal).) In its final determination, however, the Indiana Board concluded that LHA 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, LHA attempts a similar comparison: the Complex suffers from a "loss in value resulting from the [rental restrictions] which . . . mandate[] restricted rents . . . below market value[.]" (Pet'r Br. at 2.) (*See also* Pet'r Findings of Fact and Conclusions of Law at 7, ¶ 4 (stating that its "Declaration restricts the rents that can be charged . . . to an amount that is less than what [it] could charge in the absence of the Declaration").) LHA did not, however, present any evidence to support this comparison.

First, LHA presented no evidence whatsoever as to what the rental rates were for non-restricted apartment complexes in either Lafayette or Tippecanoe County during the year at issue.[12] (*See* Cert. Admin. R. in its entirety (footnote added).) Without this evidence, it cannot be determined by how much, if at all, the rental restrictions actually affect the Complex's income-producing ability.[13] *See Pedcor,* 715 N.E.2d at 436, 437 (footnote added). Secondly, during the administrative hearing, LHA explained that it did not charge what it was authorized to pursuant to the IHFA guidelines for the following reasons: "we could charge more, [but] the market in Lafayette does not allow us to . . . because the Lafayette market is completely saturated with apartments" and "we don't have [a] pool, we don't have washer[s] and dryers in the units, we don't have any of the amenities that other apartments in Lafayette have, so we have to keep our rents at a reasonable rate[.]" (Cert. Admin. R. at 487.) (*See also* Pet'r Findings of Fact and Conclusions of Law at 2, ¶¶ 8-10 (explaining that the Complex's rents were approximately 24% less than it was authorized to charge by IHFA).) Thus, LHA admits that the reason *why* the Complex charged "lower" rental rates (assuming they are, in

[12] The Court notes that as part of her appraisal, Ms. Mitchell provided information – including rental rates – on several apartment complex sales that occurred in the Lafayette area between 1996 and 1998. (*See* Cert. Admin. R. at 429-444.) *If* LHA intended to use this information as evidence of market value rental rates during the year at issue, it needed to do more. For example, not only should LHA have provided an explanation as to comparability of the apartment complexes sold with the subject property or trended the rental rates to the year at issue, it should have *at the very least* indicated that it was using the information for such a purpose. It is up to LHA to walk the State Board, as well as this Court, through every element of its analysis. *See Clark v. Dep't of Local Gov't Fin.,* 779 N.E.2d 1277, 1282 n.4 (Ind. Tax Ct. 2002). It did not; as a result, neither the Indiana Board nor this Court will subsequently make LHA's case for it.

[13] Pursuant to IHFA guidelines, LHA was authorized to charge $579 per month for a one-bedroom unit; $683 per month for a two-bedroom unit; and $779 per month for a three-bedroom unit. (Cert. Admin. R. at 315.) These rates also incorporated a utility allowance. (*See* Cert. Admin. R. at 315.) There is no indication as to how much lower these rates were than market rates.

fact, lower than market rates) was not because it was mandated to do so pursuant to the rental restrictions; rather, the reason it charged lower than market rates was so it could be competitive in the market.[14] Consequently, LHA has not demonstrated that the rent restrictions actually hindered the Complex's ability to generate income.

Likewise, LHA's evidence does not support its claim that "higher than normal vacancy rates" or "higher operating costs" were also causes of obsolescence. First, with respect to vacancy rates, Ms. Brewer testified that the Complex averaged about 15% vacancy.[15] (*See* Cert. Admin. R. at 481, 488 (footnote added).) Ms. Brewer also testified, however, that vacancy rates in Lafayette were at approximately the same level. (Cert. Admin. R. at 488-89.) Without anything more, this testimony does little to clarify *how* the Complex is suffering from "higher than normal vacancy rates."[16]

Second, to substantiate its "higher operating costs," LHA presented a two-page document, prepared by Ms. Mitchell, which indicated that "the average income and expense [per unit in] 50 apartment projects in Indiana" was $6,257 and $3,098 respectively. (Cert. Admin. R. at 449-450.) In contrast, the average income and

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[14] Despite Ms. Brewer's statements that the Lafayette market is saturated with apartments or that the Complex's lack of amenities resulted in lower rents, there is no evidence in the administrative record to support these assertions. Unsupported assertions are nothing more than conclusions, and conclusory statements do not carry any probative weight. *Kemp v. State Bd. of Tax Comm'rs*, 726 N.E.2d 395, 400 (Ind. Tax Ct. 2000).

[15] LHA submitted rent rosters that indicated that for the month of March, 2000, the Complex averaged approximately 8.33% vacancy, and as of the beginning of the month of June, 2001, the Complex averaged 11.66% vacancy. (*See* Cert. Admin. R. at 482.) (*See also* Cert. Admin. R. at 300-311.)

[16] In other words, LHA has not shown the "higher than" part of its claim: there is no evidence that its vacancy rate is higher than what the market averages.

expense per unit in the Complex was $5,526.50 and $3,087. (*See* Cert. Admin. R. at 449.) Thus, this evidence shows that the Complex's average expenses per unit *are actually lower* than the average expenses of those other properties.[17]

LHA has not linked the alleged causes of the Complex's obsolescence of which it complains with actual losses in property value resulting from those causes. As such, LHA has failed to establish the first prong in its case for obsolescence.

CONCLUSION

LHA has not made a prima facie case that the Complex is entitled to an obsolescence adjustment for the 2000 tax year. Accordingly, the Indiana Board's final

[17] There is, however, an even bigger issue with respect to LHA's use of this document. In describing the 50 other apartment projects, Ms. Mitchell states that they are "convention properties and were built between 1928 and 1998[; t]he number of units has a wide range from 12 to 648[; t]he year of the expenses are 1998, 1999, and 2000. This represents a wide range but also provides sufficient support for operating expenses due to the number of properties and management styles." (Cert. Admin. R. at 449.)

Based on this information, how can one possibly determine whether a comparison of the Complex to the 50-complex average is even relevant? Indeed, are any of the 50 complexes scattered throughout Indiana Section 42 complexes? How can you compare the operating expenses of a building built in 1928 with a building built in the mid-1990's without making some type of adjustment? Were these adjustments made? Time and time again, this Court has instructed taxpayers that when making comparisons of properties to other properties, comparability must be shown – it is not enough to merely say "they are comparable." *See, e.g., Blackbird Farms Apartments, LP v. Dep't of Local Gov't Fin.,* 765 N.E.2d 711, 715 (Ind. Tax Ct. 2002).

determination is AFFIRMED.[18]

[18] This Court has previously 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. *See 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 Ltd. P'ship v. State Bd. of Tax Comm'rs,* 694 N.E.2d 801, 806-07 (Ind. Tax Ct. 1998). These holdings do not mean, however, that if a taxpayer participates in the LIHTC Program and presents a certified appraisal that identifies a difference between the subject property's cost and income values (typically representing obsolescence), it has necessarily made a prima facie case for obsolescence. Indeed, to interpret these holdings in such a way ignores this Court's holding in *Miller Structures:* a prima facie case for obsolescence will be made only when the alleged causes of obsolescence are linked to a correlating loss in property value. *Miller Structures, Inc. v. State Bd. of Tax Comm'rs*, 748 N.E.2d 943, 954 (Ind. Tax Ct. 2001).