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IN THE
INDIANA TAX COURT

VILLAGE HOUSING PARTNERS II, L.P.,)
VILLAGE HOUSING PARTNERS VIII, L.P.,)
VILLAGE HOUSING CORPORATION,)
)
Petitioners,)
)
v.) Cause No. 49T10-0208-TA-103
)
WAYNE TOWNSHIP ASSESSOR,)
NOBLE COUNTY, INDIANA,)
)
Respondent.)

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

NOT FOR PUBLICATION
December 22, 2005

FISHER, J.

Village Housing Partners II, L.P., Village Housing Partners VIII, L.P., and Village Housing Corporation (collectively, VHP) appeal from a final determination of the Indiana Board of Tax Review (Indiana Board) valuing their real property for the 1995 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 VHP's apartment complex for the year at issue.

FACTS AND PROCEDURAL HISTORY

VHP owns Deerfield Apartments (hereinafter the Complex), a low-income housing development in Kendallville, Indiana. The development consists of 80 rental units, each with either 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, VHP received approximately $3.4 million in tax credits to award to investors who provided financing for the project. In exchange for these tax credits, VHP agreed to rent all eighty units to individuals whose income was 60% or less of the area's median gross income (adjusted for family size).[2] In addition, VHP agreed to charge rents pursuant to Department of

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[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.

[2] VHP presented evidence that the average median family income in Noble County was $41,700. (Cert. Admin. R. at 204.)

Housing and Urban Development (HUD) guidelines.[3] VHP agreed to abide by these rental restrictions for a period of thirty years.

For the 1995 assessment, the Noble County Board of Review (BOR) assigned the Complex an assessed value of $669,800. (*See* Cert. Admin. R. at 2, 32.) Believing this value to be too high, VHP appealed the BOR's valuation to the State Board of Tax Commissioners (State Board), alleging that the BOR failed to recognize that the Complex was suffering from obsolescence.

On September 19, 2001, the State Board conducted an administrative hearing on the matter. On July 3, 2002, the Indiana Board of Tax Review (Indiana Board) issued a final determination upholding the BOR's assessment.[4]

VHP filed this original tax appeal on August 15, 2002. The Court heard the parties' oral arguments on November 21, 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.*

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[3] VHP presented evidence that HUD authorized the following maximum rental rents for the Complex: $352 per month for a one-bedroom unit; $417 per month for a two-bedroom unit; and $477 per month for a three-bedroom unit. (Cert. Admin. R. at 204, 604.) VHP indicated, however, that it only charged $320 per month for a one-bedroom unit; $385 per month for a two-bedroom unit; and $445 per month for a three-bedroom unit. (Cert. Admin. R. at 204.)

[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 Supp. 2005-2006); 2001 Ind. Acts 198 § 95. Consequently, when a final determination was issued on VHP's appeal in July of 2002, it was issued by the Indiana Board.

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;
>
> (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 2005).

The burden of demonstrating the invalidity of an Indiana Board final determination rests with the challenging party. *Long v. Wayne Township Assessor,* 821 N.E.2d 466, 468 (Ind. Tax Ct. 2005), *review denied.* To meet this burden, the challenging party must present a prima facie case. *Id.* The challenging party has presented a prima facie case when it has submitted probative evidence concerning the alleged assessment error. *Id.* Probative evidence is evidence sufficient to establish a given fact and which, if not contradicted, will remain sufficient. *Id.*

DISCUSSION

In 1995, real property in Indiana was assessed on the basis of its "true tax value." IND. CODE ANN. § 6-1.1-31-6(c) (West 1995). 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(e) (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). 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 when 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) (internal citations omitted). *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,* 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). One such method that the Court has specifically accepted is the comparison of a property's market value using the income approach with the property's market value using the cost approach, and then converting the difference into an obsolescence percentage. *See Lacy Diversified,* 799 N.E.2d at 1224; *Canal Square,* 694 N.E.2d at 806-87; *Thorntown Tel. Co.,* 588 N.E.2d at 619.

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. *See id.* 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.* 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. *Id.* at 953 (citation omitted). Only after this showing has been made does the taxpayer proceed to the second-prong: the quantification of obsolescence.[5] 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 Clark,* 694 N.E.2d at 1238.

At the administrative hearing, VHP presented the testimony of two witnesses: Maureen Hougland, Vice-President of Pedcor (VHP's General Partner), and Bonnie Mitchell, an appraiser certified as a Member of the Appraisal Institute (MAI). Both Hougland and Mitchell testified that, during the year at issue, the rental restrictions caused the Complex economic obsolescence. More specifically, they explained that the Complex's inability to charge higher rental rates in order to offset its operating expenses (including the high administrative costs associated with participation in the LIHTC program) and its higher-than-anticipated vacancy rate has negatively impacted the Complex's ability to generate income. (*See* Cert. Admin. R. at 584, 596-98, 605, 636.)

To substantiate this claim, VHP submitted several pieces of documentary evidence. First, VHP submitted a statement of the Complex's financial operations from 1995 through 2000, which reveals that the Complex has operated at a loss every year since 1995. (Cert. Admin. R. at 160-65.) (*See also* Cert. Admin. R. at 584-86.)

[5] 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.*

Second, VHP submitted certified rent rolls that indicate that, as of November 1, 2000, the Complex's vacancy rate was 28%. (*See* Cert. Admin. R. at 154-59.) In addition, VHP submitted photocopies of its applications for loan disbursements. (Cert. Admin. R. at 166-67.) VHP explains that these applications demonstrate that the actual cost to construct the Complex was $4,512,924.00. (*See* Cert. Admin. R. at 166-67, 586-88.) Finally, VHP submitted photocopies of two appraisals, completed in 1993 (prior to the Complex's construction) and in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation and the Standards of Professional Practice of the Appraisal Institute, estimating the market value of the Complex as of January 1, 1995 and January 1, 1996. (*See* Cert. Admin. R. at 207, 384.)

Next, VHP presented a calculation quantifying the amount of obsolescence to which it believed it was entitled at approximately 50%.[6] More specifically, VHP:

> 1. capitalized the Complex's actual 1995 net operating income (NOI) of $58,437 at 10%[7] for a value of $584,370 (*see* Cert. Admin. R. at 162, 165, 562-63, 565-66 (footnote added));
>
> 2. subtracted $90,000 for the value of the land (as that value was determined in the 1993 appraisals) for a value of $494,370 (*see* Cert. Admin. R. at 207, 384, 562, 565);
>
> 3. added back $1,602,720 (to account for the value of the

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[6] As indicated earlier, the Complex was developed in two phases. VHP specifically seeks a 49% obsolescence adjustment on Phase I, and a 48% obsolescence adjustment on Phase II. (Cert. Admin. R. at 562, 565.)

[7] VHP's expert witness, Bonnie Mitchell, the MAI certified appraiser, testified that 10% was a reasonable capitalization rate to be applied to the subject property. (Cert. Admin. R. at 625.)

tax credits)[8] for a value of $2,097,090 (*see* Cert. Admin. R. at 562, 565 (footnote added));

4. subtracted this value from the Complex's actual construction cost of $4,069,172[9] to arrive at $1,972,082 (*see* Cert. Admin. R. at 562, 565);

5. divided $1,972,082 by the actual construction costs of $4,069,172[10] for an obsolescence adjustment of approximately 50%. (*See* Cert. Admin. R. at 562, 565.)

(*See also* Cert. Admin. R. at 622-637.)

VHP has sufficiently met its two-pronged burden: it showed how the rental restrictions negatively impacted the Complex's overall production of income (actual loss), and then it used a valid methodology for quantifying that actual loss. *See Long,*

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[8] This Court has 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, the Court has also held that any economic obsolescence occurring as a result of such rental restrictions must be measured in light of the value of the federal tax credits awarded to the project's investors. *See id. See also Hometowne Associates, L.P. v. James P. Maley, Jr., Township Assessor of Center Township, Marion County,* No. 49T10-0208-TA-98, slip op. at 17 n.17 (Ind. Tax Ct. Dec. 16, 2005) (Court advocates an approach whereby the burdens of participating in the LIHTC program are balanced against the benefits).

Consequently, VHP's calculation reflects the value of the federal income tax credits still available for use by the Complex's investors. In calculating the value of the tax credits, VHP first explains that while it initially received $3.4 million in tax credits to be used during a ten-year period, as of the March 1, 1995 assessment date, nine years of those credits remained for use. (*See* Cert. Admin. R. at 627-31.) Next, VHP explains that because the credits were purchased for $0.53 on the dollar, the credits were worth approximately $1.6 million ((($3,400,000/10) x 0.53) x 9)). (*See* Cert. Admin. R. at 627-31.) (*See also* Cert. Admin. R. at 562, 565.) *Cf. with Hometowne Associates,* slip op. at 12.

[9] The Court is confused by the use of this number, given the fact that VHP presented testimony that the actual cost to construct the Complex was $4,512,924.00. (*See* Cert. Admin. R. at 166-67, 586-88.)

[10] *See* fn. 9, *supra.*

821 N.E.2d at 468 (probative evidence is evidence sufficient to establish a given fact and which, if not contradicted, will remain sufficient). In its final determination, however, the Indiana Board concluded that VHP was not entitled to an obsolescence adjustment for two reasons.

First, the Indiana Board determined that "[VHP] has failed to demonstrate that participation in the LIHTC program created a loss in value to the property." (Cert. Admin. R. at 96.) Indeed, the Indiana Board essentially explained that VHP showed no loss in property value because: 1) VHP voluntarily agreed to abide by the LIHTC rental restrictions; 2) the demand for low-income housing in Kendallville was already low when the Complex was built; and 3) VHP had imprudently charged rents that were even lower than what it was authorized to charge under the HUD guidelines. (Cert. Admin. R. at 94-96.) Furthermore, the Indiana Board stated that, in any event, VHP was "compensat[ed] . . . to charge below-market rents. The payment is in the form of tax credits, which are used as dollar for dollar write-offs on [an investor's] federal income tax return." (Cert. Admin. R. 95.)

In the alternative, the Indiana Board held that if VHP did indeed identify causes of obsolescence that were causing its property to lose value, then "[VHP]'s method of quantifying obsolescence is flawed. The State is under no obligation to give, and does not give, [VHP's] calculation any weight." (Cert. Admin. R. at 101.) More specifically, the Indiana Board stated that VHP's quantification calculation "was flawed" because:

> 1. When determining its capitalized income figure for 1995, VHP should have used economic rent[11] for the

[11] The Indiana Board explains that economic rent "is the annual rent that is justified for the property on the basis of a careful study of comparable properties in the area." (Cert. Admin. R. at 98.)

> property at 100% occupancy, not its actual NOI net operating income;
>
> 2. VHP's calculation is based on vacancy and collection losses actually experienced by the property under appeal, rather than those determined by a study of comparable properties, as required by generally accepted standards of assessment and appraisal practice;
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> 3. While VHP's expenses were taken from the audited financial statements of the Complex, it should have used expenses incurred by comparable properties;
>
> 4. VHP failed to explain why it used a 10% capitalization rate;
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> 5. VHP utilized an incorrect method for determining the value of the tax credits; and
>
> 6. The discrepancy between VHP's claim of 50% obsolescence and the 1993 appraisals' claim of 20%[12] undermines the credibility of both calculations.

(*See* Cert. Admin. R. at 96-101 (footnote added).)

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[12] The appraisals state, in relevant part, that upon its first year of stabilized operation, the Complex should be entitled to an immediate obsolescence adjustment of 20%. (*See* Cert. Admin. R. at 236, 412-13, 613.) In arriving at this amount, the appraisals state:

> According to the Indiana Housing Finance Authority 1992 income guidelines for Noble County, a 2 person family qualified to live in Section 42 housing can earn no more than $17,920 annually. Following the 30% of income for housing rule, this [family] could afford to pay $448 per month in rent for a one bedroom apartment. This is significantly higher than the local 1993 market rent developed in the Income Approach of $375 per month. . . . To develop an estimate of an appropriate adjustment for external obsolescence, the appraiser looks at the difference between the current market rent for a one bedroom unit and the rent that the market could support based on the 30% income rule. The variance between $375 a month and $450 a month is 20.0%. A twenty percent adjustment for external obsolescence is [therefore] considered reasonable[.]

(Cert. Admin. R. at 236-37.) (*See also* Cert. Admin. R. at 412-13.)

Arguably, the Court believes the Indiana Board has raised some valid points, particularly considering what it deems to be a somewhat slapdash presentation by VHP at the administrative hearing. Nevertheless, the Indiana Board's final determination must be reversed for the following reason.

It was up to the Assessor, *and not the Indiana Board*, to rebut VHP's case. *See* IND. CODE ANN. § 6-1.5-4-1(a) (West 2002) (stating that the Indiana Board shall conduct an impartial review of all appeals concerning the assessed valuation of tangible property made from a determination by an assessing official or a county property tax assessment board of appeals). (*See also* Cert. Admin. R. at 87 (Indiana Board's final determination stating that when the taxpayer sustains its burden, "*the burden then shifts to the local taxing officials to rebut the taxpayer's evidence*" (emphasis added)).) The administrative record reveals, however, that the Assessor failed to challenge, let alone contradict, *any* of VHP's evidence identifying and quantifying the obsolescence present in its property. Indeed, the administrative record reveals that after VHP presented its case and supporting evidence at the hearing, Kim Miller, the Noble County Assessor, testified:

> MILLER: My only question is with the government telling them, you know, saying that Nob[le] County needs it [the low-income housing], then why are there so many stipulations on how much you can rent, or how much rents could be, and occupied, all of these restrictions. If they're wanting to make it a success then why is it . . .
>
> HOUGLAND: Well, unfortunately I don't know if you've ever dealt with HUD, it's tied into HUD; HUD is the department that pretty much is the umbrella over this . . . Housing and Urban Development. It's national. Part of their whole goal if I'm not mistaken, interrupt me if I am, provide affordable housing for all Americans. Unfortunately, it's a government run, bureaucratic . . .

> MILLER: That's what I'm saying . . . it doesn't make sense.
>
> HOUGHLAND: I'm not saying it makes s[ense], but there's a lot of branches of the government that don't make sense.
>
> MILLER: Oh, I know.

(Cert. Admin. R. at 638-39.) Ms. Miller made no further comment and presented no documentary evidence of her own. (*See* Cert. Admin. R. at 79.)

The Assessor failed to rebut VHP's case at the administrative hearing. When the Indiana Board issued its final determination on the matter nearly a year after the hearing, it attempted to make the Assessor's case for her. Its attempt is in vain, as it exceeds the scope of its statutory authority. *See* A.I.C. § 6-1.5-4-1(a).

CONCLUSION

VHP made a prima facie case that its property is entitled to a 50% obsolescence adjustment[13] for the 1995 assessment year. Because the Assessor failed to rebut VHP's prima facie case, the Indiana Board's final determination must be REVERSED. The Court hereby REMANDS the matter to the Indiana Board to instruct the Assessor to apply an obsolescence adjustment to the Complex consistent with the holding in this opinion.

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[13] *See* fn. 6, *supra.*