JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

F. Miscellaneous Professional Associations

10. "Impact of Changing Appraisal Regulation on the Developer", National Association of Industrial and Office Parks, September 29, 1987

Index

NATIONAL ASSOCIATION OF INDUSTRIAL AND OFFICE PARKS
Milwaukee Chapter Organizational Meeting
Tuesday, September 29, 1987

IMPACT OF CHANGING APPRAISAL REGULATION ON THE DEVELOPER

I. Fall-Out From Looting of the Savings and Loan in Commercial Lending

A. The Barnard Report

1. Need for appraisal standards and enforcement of practice
2. Appraiser must be hired by the lender for the lender
3. Loan officer must sign his concurrance with the appraisal
4. Officers and directors must have an appraisal policy, approved appraisers, and a review process or become personally liable

B. Barnard Legislation

1. Before introduced it has forced 8 major appraisal societies to create a foundation which will fund and organize an appraisal standards board and an appraisal certification board. Certification will be implemented by the state.

2. Barnard legislation would extend something to our R41(c) to all federally insured institutions, possibly including pensions.

3. Appraisers are in favor of federal participation because of enforcing sanctions against cheating appraisers is too expensive and too dangerous in terms of slander and liable.

4. Major opposition is from NAR because brokers would no longer be able to appraise if they weren't competitent to be certified.

II. Federal Savings Institutions

A. The FSDLC has put in force R41(c) which has very stringent regualtions on appraisals for construction and development loan, which include requirements for full market study, basic environmental and feasibility studies, and progressive measures of value from raw land to the development process indicating value as at certain stages of development. The loan officer and management are held personally accountable for accepting faulty appraisals. Provision is made for creating a black list of appraisers no longer acceptable. Cash equivalency is the theme for real estate interests only and other elements of value must be reported separately.

1. Value added or subtracted for financing terms
2. Value added for personal physical property
3. Value added by intangible property (such as a franchise)
4. Difference between real estate value and going concern value

B. The Federal National Mortgage Association and Federal Home Loan Bank Mortgage Corporation have redefined market value, best use, and the relevance of sales data to control the underwriting of apartment projects and condominiums. These controls emphasize cash equivalency ofcollateral value.

III. Professional Appraisal Societies

A. The American Institute of Real Estate Appraisers and the International Society of Real Estate Appraisers has been stung into reaffirming their codes of professional conduct and removing possible ambiguities from their terminology.

1. Market value has been clearly defined as the most probable price at which a property would sell for cash to the seller, assuming knowledgeable buyers and sellers under no special duress including time on the market. This benchmark value must then be adjusted for financing, other entitlements, or encumbrances which would modify the cash value upward or downward. (Exhibit 2)(missing)

2. The appraiser is expected to exercise due diligence in the section and the utilization of all relative data and concur in the data used rather than deny responsibility by means of limiting conditions and assumptions. The basic standard is that the appraiser must report all the data and procedures used so that his work can be replicated and validated as so that no miscommunication, disinformation, or sophistry can occur to mislead the reader of the report.

3. As these groups receive legislative help in terms of protecting the appraiser against economic intimidation from the client, they will exploit the wave of reform to establish significant controls on their membership and their methods.

4. Credibility will mean higher fees, longer apprenticeships, and more reliance on college training specifically in land economics and land valuation, a professional characteristic already found in Europe and in the English traditions of value surveyors.

B. Financial Accounting Standards Board (FASB) has issued a discussion paper on the appropriate use of cash or accrual accounting which will conflict with traditional appraisal and pension fund practices.

C. Several of the Big Eight accounting firms have set up special appraisal review departments since accounting practice no longer permits the auditor to sign off on appraised asset values without a judgment on the adequacy of the appraisals.

D. The European Common Market Accounting Fraternity aided and abetted by the ROYAL INSTITUTE OF CHARTERED SURVEYORS have implemented a 250 page set of standards for the appraisal of fixed assets including real estate for various financial reporting services, with a special section devoted to pension fund real estate. These standards are incorporated by reference into appraisal letters of engagement. There is continuing review and improvement by the International Assets Valuation Standards Committee.

IV. Impact on Developers Relationship to Appraisers

A. The lender will pick the appraisers, specify the product and pass through the cost to the borrower in loan fees.

B. The loan submission will contain a clause that requires full disclosure by the developer of all engineering studies, hazardous waste problems, real or imagined, and other relevant data.

C. The number of qualified certified appraisers will be minimal so there will be a long wait for the product and the price will be 3 to 5 times higher than you have been used to paying.

D. Many of your favorite appraisers in the past have found it expedient to give up their designations rather than face professional conduct investigations instigated by lenders who are stung.

E. In major communities much of the appraisal talent and marketing research will befound at the big 8 accounting firms who are acquiring the local stars by making them partners and teaching them to charge in the same way.

F. Appraisal societies now insist on cash equivalent value followed by value added items in the deal; appraisers cannot incorporate other studies by reference unless they concur and they are required to due diligence to show the basis for concurrance
Definition of value is not negotiable and encroachment on appraisal independence is securities fraud with a prospectus indicates values reported are those of an independent appraiser.

G. Appraisal societies ahve been embarrassed by the revelation of professional standards and the explosive growth of accounting firms which see appraisal as part of the business of financial information. The survivors have greatly improved their professional standards and tolerance for modern metnods and are coming out from under intimidation by their clients.

H. Notice that in the pension area the tendency to hide from appraisal pollyannas has been shattered by REEF and others who are rolling back values. Prudential has launched a reevaluation of every property in their portfolio as an audit on their outside appraisers.

I. The hottest topic in appraisal is developing letters of engagement which detail a respective obligation of the client and the appraiser and the procedures which are acceptable or unacceptable.

J. Honest objective appraisal will scuttle many speculative projects or force you to find less efficient capital sources. It may also control some overbuilding.

FEDERAL HOME LOAN BANK BOARD
OFFICE OF EXAMINATIONS AND SUPERVISION
MEMORANDUM R-41c

TO: Professional Staff—
Examinations and Supervision

September 11, 1986

FROM: Francis M. Passarelli

Appraisal Policies and Practices of Insured Institutions and Service Corporations

SYNOPSIS: THIS MEMORANDUM REVISES AND REPLACES R-41b. IT DOES NOT REPRESENT ANY SHIFT IN BOARD POLICY BUT IT DOES ENCOMPASS SIGNIFICANTLY GREATER DETAIL, SPECIFICALLY WITH REGARD TO "APPRAISAL MANAGEMENT," ADDING GUIDELINES WHICH ARE APPROPRIATE TO ENSURE ACCEPTABLE APPRAISAL PROCEDURES IN THE CURRENT MARKET. THE GUIDELINES LISTED ARE GENERALLY STANDARDS OF PRACTICE UTILIZED BY THE LEADING NATIONAL PROFESSIONAL APPRAISAL ORGANIZATIONS. THE MEMORANDUM ALSO CONTAINS THE NEW DEFINITION OF MARKET VALUE, AS RECENTLY ADOPTED BY BOTH THE FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC) AND THE FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE). R-41b IS HEREBY RENDERED OBSOLETE AND IS RESCINDED.

Introduction

The soundness of an association's or service corporation's mortgage loans and real estate investments depends to a great extent upon the adequacy of appraisals utilized to support such transactions. This memorandum sets forth the standards and reporting requirements utilized by the Federal Home Loan Bank Board in determining compliance with the appraisal requirements of Insurance Regulation 563.17-1(c)(1)(iii).

Management Policies

Loan and investment policies established by an institution's board of directors should reflect both the overall operational policies of the institution as well as the regulatory limitations under which it must conduct its business. Such policies should be clearly defined and set forth in a manner that provides effective supervision of the institution's operations by the directors.

Prudent loan policy should identify the types of credit arrangements the institution offers as well as the procedures to be followed in the underwriting of each of these arrangements. In secured credit transactions, such policies should definitely address the need to establish the value of collateral offered by borrowers in order to ensure that the institution is appropriately protected throughout the life of the credit arrangement. To a great extent, the complexity and diversity of the credit arrangements offered will determine the types of appraisal services the institution's underwriting staff will require. It is the board of directors' and senior officers' responsibility to ensure that the appraisal services provided, whether by fee or staff appraisers, properly reflect the collateral lending posture of the institution, as well as its lending policies.

Similarly, the board of directors is responsible for establishing appropriate guidelines and procedures relative to other investments of an institution. Appraisal services utilized by the institution in evaluating such transactions should reflect the institution's regulatory obligation to operate in a safe and sound manner. Failure to ensure that appraisal services match the needs of the institution will be considered an abdication of this responsibility and is representative of an unsafe and unsound operating policy.

In formulating its loan and investment policies, the board of directors should recognize that appropriate appraisal services are most often produced by fee or staff appraisers, who are both competent and knowledgeable and have properly equipped facilities within which to prepare adequate appraisals. Each association or service corporation should be able to demonstrate that the appraisers approved by the board of directors possess the requisite experience, education and facilities to perform in an acceptable fashion.

Appraisal skills and technology are not static and attendance at courses and participation in the activities of professional appraisal organizations are factors to be considered by the board of directors in selecting both fee and staff appraisers. Memberships in professional appraisal organizations as well as continuous professional development should be encouraged to ensure that the appraisers whose services are being utilized are actively increasing their knowledge and skills over time. Management should periodically review the performance of all approved appraisers for compliance with the standards and reporting requirements of the Federal Home Loan Bank Board and take whatever steps are necessary to eliminate poor quality or inappropriate work products.

Appraisal Management

Appraisals serve as an important basis in the decision process involved in the underwriting of secured credit transactions as well as investment decisions involving interests in real property. Management must ensure that appraisals utilized in these decisions:

1. Are prepared in accordance with the standards and reporting requirements of the Federal Home Loan Bank Board and conform with the institution's written appraisal guidelines. Management should provide appraisers approved by the institution with a copy of both the board's requirements, as promulgated herein, and the institution's written guidelines. Management should also assist appraisers in obtaining the information needed to comply with these requirements. Such information includes leases, purchase agreements, profit and loss statements from the security property, etc.
2. Are sufficiently current to reduce the likelihood of material changes in actual market conditions from those upon which the loan or investment decision were predicated. (Though not exclusively definitive, "sufficiently current" may be deemed to be an appraisal made six months prior to the approval of the loan or investment.)
3. Reflect the market value of the rights in realty offered as security or involved with the transaction. All other values or interests appraised must be clearly labeled and segregated, i.e., value of chattels, value of financing terms, business value, furniture, furnishings and equipment value, etc.
4. Contain sufficient information to assist management and/or the board of directors in establishing the loan amount as well as other significant terms involved in the credit arrangement.
5. Support the classification of the asset as a real estate loan or other type of credit arrangement.
6. Are prepared by appraisers, independent from the borrower or the seller of the real estate, and approved by the institution's

(Continued on page 4)

(From page 3)
board of directors. It is suggested the board review the prior work and references of newly engaged appraisers. Final board of directors' approval should be recorded in the board's minutes.

7. Contain adequate information relative to both current and projected market conditions and their resulting impact upon the estimated value of the property to enable an institution to determine whether its financial position will be properly protected over the life of the credit arrangement or term of investment. The scope of such information will depend upon the property type, the structure of the credit or investment arrangement and the financial realities of the contemplated transaction.

8. Are presented in a narrative style format, unless *both* of the following conditions are met:
   a. A form report is utilized which is appropriate for the specific appraisal assignment, i.e., the form is designed for both the property type and the interests being appraised.
   b. A form report is utilized, including all attachments, that results in a totally self-contained appraisal, as defined elsewhere in this memorandum.

9. Are based upon the following definition of market value:
   The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
   a. buyer and seller are typically motivated;
   b. both parties are well informed or well advised, and each acting in what he considers his own best interest;
   c. a reasonable time is allowed for exposure in the open market;
   d. payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
   e. the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

10. Correctly employ all recognized appraisal methods and techniques that are necessary to produce a credible analysis, opinion, or conclusion. Exclusion or omission of any recognized method for cause must be fully justified.

11. Consider, analyze and disclose in reasonable detail:
    a. Any current agreement of sale, option, or listing of the property being appraised.
    b. Any prior sales of the property being appraised that occurred within the following time periods:
       (1) one year preceding the date when the appraisal was prepared for one to four family residential property, and
       (2) three years preceding the date when the appraisal was prepared for all other property types.
    c. A sales history of comparables, if the subject property is located in a speculative market, which has experienced dramatic price fluctuations relative to regional norms, covering the speculative time period involving the comparable sales.

12. Contain the following information where an analysis, opinion or conclusion of a proposed project, improvement or change in use is involved: (i) plans, specifications, or other documentation in sufficient detail to identify the scope and character of the proposed improvements; (ii) evidence indicating the probable time of completion of the proposed improvements; (iii) clear and appropriate evidence supporting development costs, anticipated rent levels or per unit sales levels, occupancy projections, and the anticipated competition at the time of completion; and (iv) all value changes projected to occur from the conception of a project to its completion and/or stabilized occupancy should be set forth in sufficient detail so that the continuum of present value estimates over the life of the credit arrangement or investment can be reconciled with the values reported in the appraisal. Included as documentation should be an explanation of how discount and capitalization rates used in generating the present value estimates were deduced.
    In addition to the above requirements, whenever value is estimated as of completion and/or stabilized occupancy, the appraisal must contain the following information:
    a. The date or dates when the value estimate or estimates apply.
    b. Factual data supporting the reasonableness of all conditions and assumptions impacting each value conclusion cited in the appraisal. Such information must be presented in sufficient detail and directly linked to current market information so that the appraiser's logic, reasoning, judgment and analysis indicate to a third-party reader the reasonableness of the value or values reported.
    c. An explanation of the appraisal techniques selected and the data used to arrive at the final value estimate(s).
    d. A fully documented and supported highest and best use analysis and conclusion which coincides with the date(s) of the value estimate(s).
    e. A definitive statement as to whether the value estimate reflects the worth of the property at stabilized occupancy and whether the appraiser considered and included the effect of income and expenses during the projected absorption period in developing a value estimate as of the date of completion.

13. Accurately reflect the impact upon value of any changes in plans and specifications from those utilized in an appraiser's analysis of a proposed project, improvement or change in use.
    In all instances where an institution utilizes an appraisal based upon preliminary plans and specifications in a loan or investment decision, it shall take appropriate steps, prior to the disbursement of any funds, to ensure the validity of the appraisal, relative to the decision, has not been negated. Further, whenever significant changes in plans and specifications occur after a loan or investment decision has been made, the institution's management shall take appropriate steps to ensure its financial position is appropriately protected. Typically, such steps will involve either having the original appraiser recertify his value estimate after examining the final plans and specifications for the project or a new appraisal will be obtained based on the final plans and specifications.
    For the purposes of this paragraph, significant changes in plans and specifications are defined as those which directly affect the value of the property, e.g., changes in the scope, character or timing of the proposed improvements.

14. Contain a properly documented and supported estimate of the highest and best use of the property appraised, which is consistent with the definition of market value cited in this memorandum. Such estimate must consider the effect on use and value of the following factors: existing land use regulations, reasonably probable modifications of such land use regulations, economic demand, the physical adaptability of the property, neighborhood trends, and the optimal usage of the property. In addition, the appraisal must consider the effect on the property being appraised of anticipated improvements as of the appraisal date.

    In all appraisals, incuding those involving proposed construction, development or changes in use, the appraiser must specifically address and consider in his analysis the anticipated economic feasibility, as well as cite all significant market data utilized in developing his/her conclusions. Such analyses must be presented in sufficient detail to support the appraiser's forecast of the probable success and the conclusion of highest and best use of the project.
    In all instances where the appraiser relies on feasibility/marketability studies prepared by a third party to support his esti-

mate of highest and best use, he must:

a. Attest that such study has been thoroughly examined and that he fully concurs with its findings and conclusions, and;

b. Specifically identify both the study examined as well as set forth within the body of the appraisal, a summary of the significant data, analyses and conclusions presented in the study. Such summary must be presented in sufficient detail, so that further reference to the study is unnecessary by a third-party reader of the appraisal, and;

c. Have available for future examination by users of the appraisal, a complete copy of the feasibility/marketability study prepared by the third party.

15. Report the market value to a single purchaser as of the date of completion for all properties, wherein a portion of the overall real property rights or physical asset would typically be sold to its ultimate users over some future time period. Valuations involving such properties must fully reflect all appropriate deductions and discounts as well as the anticipated cash flows to be derived from the disposition of the asset over time. Appropriate deductions and discounts are considered to be those which reflect all expenses associated with the disposition of the realty, as of the date of completion, as well as the cost of capital and entrepreneurial profit.

16. For properties under construction, conversion or proposed, report the market value of the subject property as of the date of completion, excepting those properties described in paragraph 15 immediately above, where anticipated market conditions indicate stabilized occupancy is not likely as of the date of completion. Such valuations shall fully reflect the impact upon the "as if completed value" of all pertinent operating expenses as well as the anticipated pattern of income during the absorption period. In addition, the value estimate must reflect the impact of rental and other concessions, including the costs associated with preparing the improvement for occupancy by tenants.

17. Contain a summary of actual income and expenses experienced by the subject property where it is an existing income or revenue producing property. In addition, all such appraisals must contain a complete reconciliation of all deviations projected by the appraiser in his forecast of future financial performance from those historically realized by the property.

18. Report the "as is" value of the subject property as of the date when either the appraisal was prepared or when the property was last inspected. The date of the "as is" value estimate should be sufficiently current to reduce the likelihood of material changes in the actual market conditions from those upon which the loan or investment decision were predicated. In addition to any other value estimates contained in an appraisal, the "as is" value must be reported.

19. Consider and report the effect on value, if any, of the terms and conditions of any agreement establishing a fractional interest or estate, where the objective of the report is to estimate the value of uch fractional interest or estate. All such appraisals must clearly demonstrate that the value of any fractional part or estate has been evaluated by an analysis of appropriate market data. Such analyses must recognize that it is generally considered inappropriate to arrive at either the value of the whole or its parts by simply summing the fractional interests or subdividing the value of the whole into proportional parts.

All analyses involving fractional interests or estates, where the combined value of all interests or estates is not reported, must definitely establish with market evidence whether the terms and conditions of the agreement creating the estates or fractional interests reflects market rates and terms.

In addition to the above requirements, all analyses involving fractional interests or estates must disclose whether the final value estimate of such fractional interests or estates included non-realty components, i.e., tenant or borrower's credit quality other non-realty contractual arrangements, etc. Further, whenever such value estimate includes non-realty components, the value assignable to them must be specifically disclosed in the appraisal.

All appraisals, where there is a clear indication that the subject property is encumbered by a lease instrument or legal limitations upon its operation (e.g., when inspection reveals occupancy of the property by tenants or the property is subject to rent control statutes), must consider and report the impact of the terms of the lease or such legal limitations upon the value of the estate being appraised.

Appraisal Content

Prior to the approval of a loan or investment transaction, each appraisal accepted by an institution must be prepared in writing and contain sufficient information to enable the persons who receive or rely on the report to understand it properly. Appraisals which fail to set forth, in a clear and accurate manner, the analytical process followed by the appraiser, in a fashion that will not be misleading to the persons who receive or rely on the report, will be considered unacceptable.

The content of each appraisal accepted by an institution shall follow generally accepted and established appraisal practices, as reflected in the standards of nationally recognized professional appraisal organizations and as noted in the body of this memorandum.

Specifically, each appraisal must:

1. Be totally self-contained so that when read by any third party, the appraiser's logic, reasoning, judgment and analysis in arriving at a final conclusion indicate to the reader the reasonableness of the market value reported.

2. Identify via a legal description the real estate being appraised.

3. Identify the property rights be appraised.

4. Describe all salient features of the property being appraised.

5. State that the purpose of the appraisal is to estimate market value as defined in this memorandum.

6. Set forth the effective date of the value conclusion(s) and the date of the report.

7. Set forth all relevant data and the analytical process followed by the appraiser in arriving at the highest and best use conclusion.

8. Set forth the appraisal procedures followed, the data considered, and the reasoning that supports the analyses, opinions, and conclusions arrived at by the appraiser. The analytical process followed by the appraiser must be presented so that:

(a) It includes a complete explanation of all comparable data adjustments utilized in the analysis together with appropriate market support for each adjustment, and;

(b) It contains descriptive information for all comparable data presented with sufficient detail to demonstrate the transactions were conducted under the terms and conditions of the definition of value being estimated or have been adjusted to meet such conditions; have a highest and best use equivalent to the best use of the subject property, and; are physically and economically comparable to the subject property.

9. Set forth all assumptions and limiting conditions that affect the analyses, opinions, and conclusions in the report; however, such assumptions and limiting conditions must not result in either a non-market value estimate or one so limited in scope that the final product will not represent a complete appraisal. A summary of all such assumptions and limiting conditions must be presented in one physical location within the appraisal.

10. Include a manually signed certification by the appraiser that is similar in content to the following form:

- the statements of fact contained in this report are true and correct.

(Continued on page 6)

R-41c

from page 5)

- the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest or bias with respect to the parties involved.
- my compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or the use of, this report.
- my analyses, opinions, and conclusions were developed, and this report has been prepared, in accordance with the standards and reporting requirements of the Federal Home Loan Bank Board.
- I have made a personal inspection of the property that is the subject of this report. [If more than one person signs the report, this certification must clearly specify which individuals did and which individuals did not make a personal inspection of the appraised property.]
- no one provided significant professional assistance to the person signing this report. [If there are exceptions, the name of each individual providing significant professional assistance must be stated.]

Related Considerations

Appraisal reports prepared for the purpose of influencing in any way the action of a Federal Home Loan Bank, the Federal Home Loan Bank Board, a Federal Savings and Loan Association, any institution the accounts of which are insured by the FSLIC, any member of the Federal Home Loan Bank System, or the Federal Savings and Loan Insurance Corporation are subject to the provisions of Title 18, United States Code. It is encumbent upon all appraisers to diligently adhere to generally accepted professional appraisal standards of practice and the provisions and requirements of the Federal Home Loan Bank Board's standards and reporting requirements relating to the preparation of appraisal reports prepared for these entities.

Francis M. Passarelli
Director [FHLBB]

Kinnard Writing R-41c Seminar

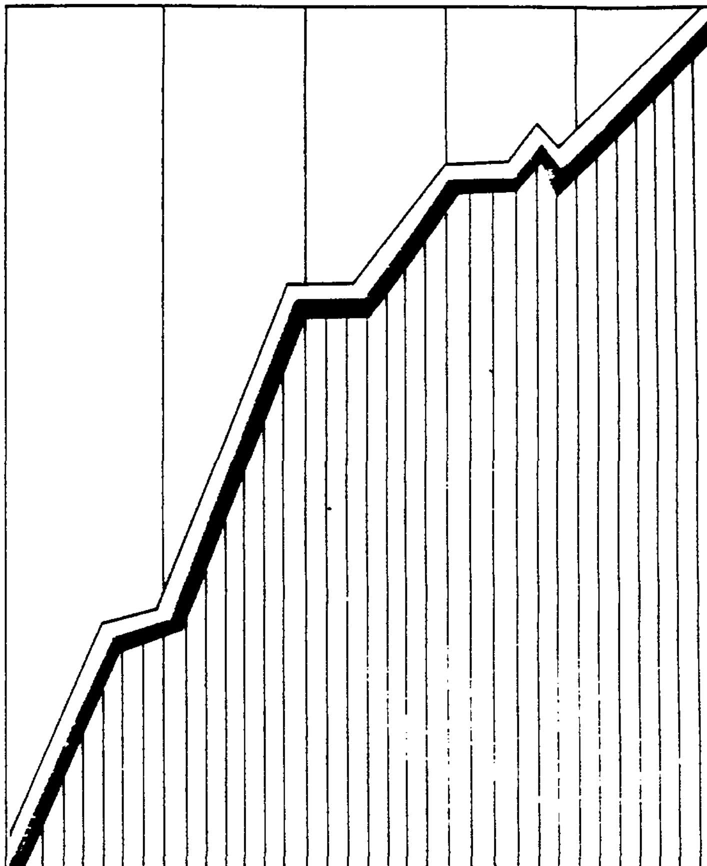
With the Federal Home Loan Bank Board's release of Memorandum R-41c, the Society is preparing an accompanying seminar.

Dr. William N. Kinnard, Jr., SREA, the author of "R-41b and the Appraiser," will also be the author of the Society's new R-41c offering.

The seminar should be available for chapter presentation by late 1986.

Pilot Presentation of R-41c and the Appraiser, Tucson, Arizona, Arizona Inn, **November 7**; Dr. William N. Kinnard, Jr., SREA, instructor. Contact: Thomas A. Baker, 2500 N. Tucson Blvd., Suite 100, Tucson, AZ 85716; (602) 881-1700; sponsored by Tucson #116; 7 hours recertification credit.

Pilot Presentation of R-41c and the Appraiser, San Diego, California, Inter-Continental Hotel, **November 20**; Dr. William N. Kinnard, Jr., SREA, instructor. Contact: Don Knox/Janan Fussell, 4452 Park Blvd., #302, San Diego, CA 92116; (619) 295-1670; sponsored by San Deigo #33; 7 hours recertification credit.



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"Highest and Best Use," one of the four magazine advertisements which have been placed throughout the year to promote Society members, will appear during the latter part of 1986 in the following publications: *Corporate Real Estate, National Law Journal, Trial,* and *Mortgage Banking.*

During the last quarter of 1986, those who request copies of the Directory of Designated Members will receive the 1987 issue, which will be mailed in January. For those who need immediate information, copies of local listings from the current directory are available.