

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

F. Miscellaneous Professional Associations

12. "The Appraisal Process and Pension Fund Real Estate Investment", Pension Fund Real Estate Capital Investment and Management, Session 9, for the Institute of Real Estate Management (IREM), April 22-23, 1982, Chicago

INSTITUTE OF REAL ESTATE MANAGEMENT
430 N. Michigan Avenue
Chicago, IL 60611

Presents The

PENSION FUND REAL ESTATE INVESTMENT & MANAGEMENT CONFERENCE

April 22-23, 1982
Hyatt Regency Chicago Hotel

Prof. Richard T. Garrigan, Moderator
DePaul University, Chicago, IL

Mr. Claude M. Ballard, General Partner
Goldman, Sach & Co., New York, NY

Mr. Ronald C. Boller, Dir. of Portfolio Mgmt.
Owens-Illinois, Inc., Toledo, OH

Mr. Eugene J. Burger, CPM®, President
Eugene Burger Management Corp., Sausalito, CA

Dr. Anthony Downs, Senior Fellow
The Brookings Institution, Washington, D.C.

Mr. Blake Eagle, Senior Vice President
Frank Russell Company, Tacoma, WA

Mr. Kurt Freundlich, Vice President
First National Bank of Chicago, Chicago, IL

Prof. James A. Graaskamp, School of Business
University of Wisconsin-Madison *

Mr. Richard A. Hanson, Partner
Coopers & Lybrand, Chicago, IL

Mr. Peter M. Kelly, Partner
Kirkland & Ellis, Chicago, IL

Mr. Jerry M. Reinsdorf, Chairman
The Balcor Company, Skokie, IL

Mr. Brian J. Strum, Vice President
The Prudential Insurance Company of America, Newark, NJ

Mr. Michael S. Young, President
Shlaes & Young Information Systems, Chicago, IL

MR. CLAUDE M. BALLARD

Mr. Claude M. Ballard is a general partner of Goldman, Sach & Company. He was a senior vice president for eight years at Prudential Insurance Company, where he handled equity operations in real property and in PRISA, the commingled real estate account for qualified pension funds. He is a former preesident of the Urban Land Research Foundation and is secretary of the Urban Land Institute and a trustee and member of the executive committee of its board of trustees.

MR. EUGENE J. BURGER, CPM®

Mr. Eugene J. Burger, CPM®, was the 1981 president of the Institute of Real Estate Management (IREM). He is the president of his own management corporation, which manages more than 7,000 residential units, office buildings and shopping centers throughout California, Nevada and Oregon. Burger is active in the California Association of Realtors®, the Buildings Owners and Managers Association and the Community Associations Institute.

DR. ANTHONY DOWNS

Dr. Anthony Downs is a senior fellow at the Brookings Institute in Washington, D.C. He has been a real estate consultant for some of the nation's largest corporations and for several government agencies, including the Department of Housing and Urban Development. He has written numerous books and over 200 articles, many of them on the subject of real estate investment in the U.S. economy. Downs is now working on a book on real estate finance in 1980s.

MR. BLAKE EAGLE

Mr. Blake Eagle is a senior vice president of the Frank Russell Company, a major pension fund consultant firm in Tacoma, Washington. There, he manages all real estate research and investment planning. During his career, he has seen all aspects of real estate, having worked as a broker, syndicator, developer and builder. He is a graduate of the University of Washington, with post-graduate studies at the University of California.

PROF. RICHARD T. GARRIGAN

Prof. Richard T. Garrigan, the moderator, is the president of his own real estate consulting firm. He has written several articles on the subject of pension fund real estate investment and is now co-editing a book, The Secondary Mortgage Market Handbook, to be published in 1983. Garrigan serves as a consultant to the Balcor Company. Formerly, he was a presidential exchange executive at the Federal Home Loan Bank Board in Washington, DC.

PROF. JAMES A. GRAASKAMP

Prof. James A. Graaskamp is the chairman of the Department of Real Estate and Urban Land Economics in the business school of the University of Wisconsin and is the president and founder of Landmark Research. He is on the Board and Executive Committee of First Asset Realty Advisors, a subsidiary of First Bank Minneapolis. Graaskamp is the co-designer and instructor of the EDUCARE teaching program for computer applications in real estate.

MR. RICHARD A. HANSON

Mr. Richard A. Hanson is the chairman of the National Real Estate Group and is a tax partner in the Chicago office of Coopers & Lybrand. He has been a tax consultant for many private and public real estate partnerships. He is chairman of the Tax Committee of the Real Estate Securities and Syndication Institute of the NATIONAL ASSOCIATION OF REALTORS®. Hanson also writes a monthly tax column for the Chicagoland Real Estate Advertiser.

MR. PETER M. KELLY

Mr. Peter M. Kelly is a partner in the law firm of Kirkland & Ellis, where he supervises the staff handling all cases involving employee benefits, pension funds and profit sharing. He has authored many articles including "ERISA Reporting and Disclosure: Status Report." He is chairman of the Committee on Reporting and Disclosure, Section of Real Property, Probate and Trust Law, of the American Bar Association.

MR. MICHAEL S. YOUNG

Mr. Michael S. Young is the president of Shlaes and Young Information Systems, a company that specializes in computer software for the real estate industry. Users of the Shlaes and Young systems include a major bank, insurance company and pension fund investment advisor. Young is the author of many articles on investment valuation and risk analysis and is co-author of a book that deals largely with the capital growth of real estate properties.

IREM

PENSION FUND REAL ESTATE CAPITAL INVESTMENT & MANAGEMENT

Session 9: The Appraisal Process and Pension
Fund Real Estate Investment

- I. The Gap Between the Accounting GAP and Appraisal GAPS
 - A. Book Value Versus Market Value
 1. Capitalization or expensing of acquisition costs
 2. Reserves for deferred maintenance and investment for future income
 3. Fee simple title or enterprise entitlements
 4. Sale of possessory interests or entitlements
 5. Inflation accounting rules (FASB)
 - B. Relevance of the Definition of Value
 1. Implicit assumptions of fair market value
 2. Fair market value, cash equivalency, liquidating value, and terms generally found in the marketplace
 3. Full disclosure: market value less leasehold interests itemized or investment value of contract interests before taxes
- II. Validity of the Three Approaches to Value as They Apply to Pension Funds
 - A. Validity in Terms of Predicting Price, Measuring Premium, Avoiding Fiduciary Liability
 - B. The Cost Approach
 - C. The Market Approach for Major Properties
 - D. The Classic Income Approach
 - E. Discounted Cash Flows on a Ten Year Forecast With Sensitivity Dimensions
 - F. Which Set of Assumptions do You Buy?
 - G. Which Professional Organization Should Set the Standard?
- III. Pension Fund Administration of the Appraisal Process
 - A. Objectives and Parameters
 1. Full disclosure
 2. Coordination of appraisal and accounting
 3. Definition of appraisal frequency and type
 4. Selection of appraisers to avoid bias and vested interest
 5. Who defines which assumption?

- B. Selection and Solicitation of Appraisal Services**
- C. Tests of Appraisal Conclusions**
- D. Ethical Considerations in Appraiser Relationships**
- E. In-House Appraisal reviews and Value Adjustments**
- F. Reporting of Appraisal Benchmarks Annually and Cumulatively**
- G. Significance of Annual Appraisal - Minimizing Penalty Early Withdrawal or Maximizing Annual Contribution to Pension Fund Assets**

APPRAISAL ENGAGEMENT LETTER

TO:

RE: Property Identification

Dear _____:

On behalf of First Asset Realty Advisors (FARA), we would like to engage your services for the appraisal of the above property to determine the fair market value of the legal interests owned by a Commingled Fund as of (date of appraisal). To that end and before accepting the assignment, the appraiser should consider the following requirements as to definition and procedure:

1. Fair market value shall be defined as the most probable price at which the property would sell to a knowledgeable buyer on a given date if placed on the market for a reasonable length of time by a well informed seller assuming:
 - a. Cash to the seller or cash plus debt owed or assumed by the buyer, where appropriate.
 - b. Fee title will be encumbered by leases in place and possible other covenants. Appraiser must indicate remaining market value of these other leasehold or non-possessory interests.
 - c. The appropriate exposure on the market has occurred prior to the date of sale.
2. Fee title may be encumbered by leases, mortgages, as well as possible conditional use permits and private covenants. FARA is obligated to provide access to all of the appropriate documents at the office of _____ located at _____ during normal business hours. The appraiser is expected to read the leases, mortgage instruments and other encumbrances and relate to them appropriately. If existing debt is assumable by another buyer, then the appraiser can value the sale as cash to the seller with the buyer accepting the mortgage(s) already in place if that would be consistent with the most probable buyers self interest. Otherwise the trustees of the Commingled Fund management (FARA) are interested in a value which is the most probable cash price to the seller and with the buyer accepting the existing encumbrances in terms of leases and covenants, etc.
3. When using the market comparison approach, the appraiser must document each comparable sale as to grantor, grantee, public record, plot plan and photograph as well as basic details of construction

and existing encumbrances, terms of sale, and seller motivation. Buyer motivation is profiled as an assumption by the appraiser. All calculations necessary to adjust engineered prices to cash equivalencies must be documented and explained as well as any and all adjustments to relate the comparable price to the subject property must be itemized and explained so that the reader can repeat the mathematical adjustments.

4. The income approach must use discounted cash flow from a ten-year forecast (and your own forecast, if different) in which all the property's existing leases are detailed individually. The rationale for roll-over vacancies, absorptions, and expense projections must be itemized with a series of footnotes in the manner of a fully detailed accounting income and balance sheet statement. Income projections should account for current market lease rates with explanations of all assumptions used. Normalized income methods including investment bond, Ellwood or net income multipliers are not acceptable.
5. The appraiser must document his opinion as to the appropriate discount rate applied to each segment of the cash throw-off and after tax cash flow as appropriate, together with financing terms assumed.
6. A cost approach based upon a responsible service or professional should be supplied with the initial appraisal. If it is not used in the final valuation, then a discussion on why it is not used is required. The appraiser is expected to carefully inspect the property and report his own independent views on the quality of maintenance, deferred maintenance, and tenant housekeeping.
7. The appraiser is regarded as the eyes and property inspector of FARA. To put the property in context, the appraiser must supply a separate market analysis section to include current market conditions, an evaluation of projects which are competitive alternatives in the market area of the appraiser, an indication of rent structures, vacancy and absorption rates, and in the case of a new building, some indication as to rentup success and source of tenants. Wherever possible, the appraiser is to indicate the ownership and character of investment position in competitive properties and the property management or leasing term involved with each. The appraiser should include in his market analysis section an evaluation of the future projected market conditions over the ten-year holding period.

Following the initial appraisal at the time of acquisition, the appraiser will be asked to submit a letter of review 180 days after the date of the original appraisal indicating if he would modify any of his critical assumptions at that time and, if so, indicating how this might affect his original value estimate as a specific dollar adjustment, up or down.

At the end of 360 days, the appraiser would be expected to perform a thorough review of his original appraisal, specifically focusing on the market approach (item 3), adjustments indicated for the income approach (items 4 and 5), and

additions and amendments to market data (item 7). Aside from the specific instructions provided in paragraphs 1-7 above, it is anticipated that all work will be done according to the standards of the American Institute of Real Estate Appraisers, and it is further understood that the client for whom the appraisal is done for purposes of professional accountability is both First Asset Realty Advisors, Inc., and its operations agent, The Center Companies of Minneapolis, Minnesota. Purpose of the appraisal is to meet the asset valuation requirements of an open-ended, commingled real estate fund suitable for investment by pension fund programs subject to ERISA.

Please return both copies of this letter together with an indication of your fee for the appraisal services above by (date) with a separate quote for the initial appraisal, the 180 day review, and a 360 day reappraisal and an estimate of the date the appraisal will be completed. If this is your first assignment for FARA, please include a sample of your work, preferably of a similar property, in which you have provided for the necessary cash flow projections.

Yours very truly,