

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

VII. INDUSTRY EDUCATIONAL COURSES - LONG TERM

H. Northwest Center For Education

4. "Pension Fund Real Estate Valuation Issues",
in New York, September 27, 1985 and in San
Francisco, California, November 10-13, 1985:
Includes program materials and correspondence

PENSION FUND
REAL ESTATE VALUATION ISSUES

Presented by

Professor James A. Graaskamp
School of Business
University of Wisconsin

September 27, 1985

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November 10-13, 1985

NORTHWEST CENTER FOR PROFESSIONAL EDUCATION

One Day Seminar

REAL ESTATE VALUATION ISSUES FOR PENSION FUND REAL ESTATE

8:30 - 10:00

The case for greater standardization of appraisal/
accounting reporting for asset valuation and performance
measurement

- A. Appraisal process must respond to issues for which appraisal is required as a benchmark
 - 1. Adequacy of pension funding
 - 2. Entry/exit unit values of co-mingled shares in real estate pools
 - 3. Performance of asset managers
- B. Traditional presumptions of appraisal standardization
 - 1. Appraisal format imposed by professional societies in the U.S.
 - 2. Appraisal format imposed in the Common Market
 - 3. Appraisal format under development for imposition by American intermediary banking institutions, i.e. FHLB, FDIC, and FNMA
 - 4. Guidelines for pension managers by NCREIF
- C. Proposed research process of actual appraisal practices of pension real estate managers and methodology
 - 1. Formal pension policy, if any
 - 2. Selection and control of appraisals for asset measurement
 - 3. Pattern of practice revealed in actual paired appraisals
 - 4. Procedure and controls on internal appraisal values by asset managers between anniversary appraisals
- D. Preliminary findings of study financed by PREA interpreted by Graaskamp and Gibson are basis for following discussion

Coffee Break

10:15 - 12:00

Suggested requirements for developing consistent appraisal quality and performance by appraisers

- A. Basic components of standardization process
 - 1. Standards promulgated by industry association
 - 2. Written policy statement by pension fund sponsor

3. Written appraisal method statement to implement #2 by asset manager
4. Letter of engagement to the appraiser
5. Explicit methodology and terminology from appraisal association
- B. Standards promulgated by industry association
 1. FASB and MAIs
 2. Consistency with NCREIF guidelines
 3. Objectives of ERISA
 4. Total fee income and substantial economic ties constituting conflict of interest
 5. A vacuum of appraisal standards or white paper methods
- C. Valuation controls imposed by pension sponsor
 1. Frequency, quality, and independence
 2. Parameters for projection and simulation
 3. Responsibility for structural and mechanical engineering integrity
 - ~~4. Permissible level of aggregate simulation~~
 - ~~5. Segregated accounts vs. open co-mingled accounts~~
 - ~~6. Accounting issues in the aggregate~~
 - ~~7. Is the absence of specification relying on comprehensive interpretation of fiduciary responsibility?~~
- D. Some suggested formats

LUNCH

1:00 - 2:30

Basic problems in appraiser execution of the market approach to values

- A. Failure to establish the best unit of comparison between properties
- B. Failure to report terms of sale or quantitative adjustments for cash equivalency
- C. Failure to establish rules for selection and quantification of accounting patterns
- D. Failure to explain adjustments for differences
- E. Failure to report addresses and transaction details of comparables
- F. Other findings

Coke Break

2:45 - 3:45

The perceived need for a standardized accounting format, accounting rules, and assumptions

- A. Inconsistency of discounted cash flow concepts and appraisal pro forma accounting
- B. Establishing formats for revenue schedules, expense schedules, and working capital commitments to amortizable assets such as tenant improvements, lease renewal commissions, and financing charges
- C. Providing the appraiser with receipt and expenditure models pre-build by accountants for market review by appraisers--an ethical issue?

1. Independence vs. integration of accounting-
budgeting and appraisal forecasting
 2. Selecting value benchmarks relevant to
solvency, resale, and comparative
performance of asset manager
 3. Accounting vs. appraisal relative to
replecation, validation, and representativeness
of economic results
- D. Alternative methods of income property valuation
control revealed by PREA study

3:45 - 4:30

Philosophies and practices of asset managers relative to
internal appraisal procedures

- A. Alternative internal procedures and controls
- B. Justification of quarterly adjustments to
independent appraisals
- C. Integration of capital expenditures during
interim period with independent appraisers
- D. Reallocation of values relative to leasehold
value and investment value due to passage of
time and perceived changes in discount rates
- E. Should quarterly sequence of appraised value
changes and source of change be indicated for
each property for fund investors?

4:30 - 5:00

Alternatives to more disciplined appraisal practices
that would be easier to implement and more cost effective

- A. Valuation reserves reflecting potential
appraisal bias to the high side, which are
deducted from asset value
 1. Effect is to provide a bid and asked unit
price
 2. Effect recognizes that investors who are
exiting see less favorable risk/payoff
matrix than those who are remaining or
investing
- B. Dollar-averaging of commitments to invest or
disinvest over six quarters so that two
independent appraisals of total portfolio could
have occurred
- C. Prohibiting quarterly internal adjustments
to value with the exception that capital
expenditures would be carried as a separate
account to the next valuation date of each
property

PENSION FUND
REAL ESTATE VALUATION ISSUES

Presented by

Professor James A. Graaskamp, Ph.D., CRE, SREA
University of Wisconsin, School of Business

INTRODUCTION

- I. Appraisal is a specialty in the rapidly evolving information business in a society where a majority of the people are involved in information processing. Appraisers systematically collect information, organize, analyze, and interpret the data, reach decisions and communicate essential information to a client.
 - A. Real estate appraisal is a pivotal benchmark for decisions involving social equity (eminent domain and real estate taxes), validation of value for regulatory purposes (loans and pension security), benchmarking of asset management performance (pensions and fixed assets on balance sheets), and counseling for allocation of land uses and cost effective capital allocation. Ethical issues pervade the process.
 - B. Information processing by appraisers is similar to the work of accountants, lawyers, investment counselors, and insurance people. Unlike accountants and others, appraisers receive little help from their professional organizations in the form of position papers which define appropriate methods for a particular question.
 1. Financial Accounting Standards Board (FASB) continually modifies generally accepted accounting principles to fit new problems such as mergers, current values of fixed assets, accounting for real estate operations, etc.
 2. The Lawyers' Ethics Committee has placed responsibility for "misleading" appraisals in tax work and eminent domain on the attorneys. The IRS can blacklist appraisers whose values exceed 150 percent of ultimate courtroom settlements.
 3. Securities people have the SEC, Midwest Securities Associations, and various licensing agencies.

4. Appraisers have no such independent source or consensus. Even the eighth edition of the American Institute of Real Estate Appraiser's (AIREA) textbook, The Appraisal of Real Estate, disclaims any responsibility for being a standard.
- C. In the absence of professional standards, appraisal clients have taken responsibility for initiating true reforms or exploiting nominal format disinformation.
1. In the 1930s, reform of the residential mortgage markets led to development of the three approaches and creation of the Institute in order to define a standard of malfeasance and self-policing organization to control malpractice. The hope was that a very systematic format would provide a standard for evaluating performance.
 2. The volatility of real estate values due to inflation and the legal risks and costs of enforcement made it difficult to operationalize professional enforcement for 25,000 appraisers. However, pension fund real estate may involve only 250 appraisal firms or appraisers.
 3. Systematic formats once taught to everyone dealing with appraisal without stringent review leads to the potential for disinformation.
 4. Disinformation is military intelligence language for providing information which appears to be correct in form and terminology so that the reader rationalizes to the wrong conclusion.
 5. Disinformation through an appraisal format is a conspiracy of cooperation between the appraiser and his client to satisfy regulators, provide cover against second guessing on transactions which go awry, or rationalize common objectives to make a mortgage loan, negotiate real estate taxes, negotiate divorce settlements, etc.
- D. The opportunity for disinformation has been enhanced by low cost minicomputers which encourage standard formats for word processing and use of large data banks of unknown quality.
1. Sophisticated formats and boilerplate prose in industrial volume tend to conceal the validity of assumptions driving the process.
 2. Data banks lead to unknowing or deliberate misuses of statistics. Ultimately, the Home Loan Bank had to disallow single family home appraisals

using Ellwood because of the subtle potential for distortion of the appraisal process.

3. The ethics of data analysis, manipulation, and communication is overwhelming the professional societies and the costs of abuse are falling on public institutions such as FSLDIC and ERISA, rather than the appraiser or his client.
- E. The appraisal process was therefore unprepared to deal with real estate investment and fiduciary account where values had to be determined monthly, quarterly, or annually.
1. Real estate is a long-term investment which does not lend itself to constant measurement of value perceived, actual or by inference, from a market of fungible goods.
 2. The cost of proper valuation as well as the time to conduct the appraisal make any result untimely and less than cost-effective.
 3. The cost of cheap appraisal is a loss of sensitivity to the value fluctuations necessary to validate asset values, measure performance of the asset, or monitor the skills of the asset manager.
- F. Quality control of the appraisal process for pension fund assets will require a broad set of administrative efforts by associations of pension sponsors, asset managers, and appraisal organizations to overcome the general distrust of appraisal created by its use for disinformation in other areas and to accomplish its goals in facilitating efficient use of real estate capital.
1. Pressure must be taken off the cost-effectiveness of the appraisal process by reducing the frequency, but increasing the quality of independent appraisal by changing existing administrative policies.
 2. An association of pension sponsors and ERISA must establish the standards for selection and performance of appraisers since appraisal organizations are not well-equipped to deal with narrow specialities within a generic profession.
 3. Appraisal clients and appraisal organizations specifically concerned with pension real estate

will have to create their own appraisal methodology to meet objectives in a proactive format.

G. To that end, it will be useful to review various efforts to interface appraisal theory, methodology, and institutional regulatory objectives, in general, as well as in reference to pensions, in particular.

II. The general conceptual framework of the appraisal process has been expanding at a rate which would keep pace with information processing tendencies of our society. Valuation theories range from the mysticism of Dilmore to the pragmatism of Ratcliff to the deductive idealistic logic of traditional approaches.

A. In the information game there are three approaches to valuation methodology, according to Dilmore.

1. ORDER assumes under everything is a universe in which the parts fit, information has a shape. Remember the test for color blindness, as random dots in random colors until suddenly you see the red dots only as a letter or number. As appraisers, we look for the red dots. We try to organize data objectively which has been subjectively collected and perhaps naive.
2. CHANCE acknowledges the possibility of alternative outcomes in our little closed system. Imprecision is inherent to behavioral science. No respectable scientist is afraid of the work error or variance. We know in part and see but through a glass darkly. We may be able to predict without always understanding cause and effect because of unknown cross-correlations.
3. BEAUTY can be a legitimate basis for constructing a hypothesis--elegance is the ultimate intuitive choice, judgement, or gut response. Models may be elegant and not fully understood, but useful and sometimes dangerous like Ellwood, regression, and cost.

B. Each of the above may have application to the pension process to the effect that current value can be stabilized with standardized methods stressing investigation to expose the exception; chance must be an appropriate way of measuring present value of uncertain futures, and elegance may lead to development of portfolio models based on the entire portfolio of leases by industry rather than individual buildings per se or some other concept.

- C. Ratcliff restated contemporary real estate appraisal theory into an inductive, pragmatic process to be further considered today.
1. The issue for which the appraisal is sought as a benchmark would define value, the assets to be included in the appraisal, and the necessary cost effectiveness of the process. For Ratcliff, it was an inductive process which moved from description of the property to identification of alternative uses.
 2. Alternative uses could be evaluated to identify the most probable use, which in turn would identify the most probable buyer type.
 3. The appraisal problem was to forecast the price at which the most probable buyer and seller would make a deal under a specific set of decision rules or conditions.
- D. For Ratcliff, the best way to forecast how a specific buyer-type would behave in the future was to observe how they had behaved in the past in similar circumstances. Ratcliff advocated a specific hierarchy of approaches to valuation, once again a trinity, (1) INFERENCE FROM A SET OF MARKET TRANSACTIONS, (2) BUYER SIMULATION, or (3) NORMATIVE METHODS OF DEDUCTIVE LOGIC.
1. MARKET INFERENCE from a set of market transactions required actual transactions involving properties with similar productivity potential as the subject property to be appraised and buyers presumed to have similar motivation to the most probable buyer identified from the scenario of alternative uses. Depending on the number of available data points, inference could involve statistics, set theory, or simple bracketing.
 2. BUYER SIMULATION of the buyer calculus may be required in the absence of definitive sales. Simulation can range from conventional benchmarks like price per barrel of cranberry production or licensed nursing home beds to discounted cash flow models using probability techniques.
 3. NORMATIVE methods are the deductive logic of economists and appraisers reflecting what the market should do if it were as smart as the appraiser. Deductive approaches like the cost approach are the least likely to be predictive of market behavior, and therefore inappropriate for predicting most probable price, but logically

compatible with the artificial concept of fair market value.

- E. The traditional approaches at a simple, idealistic logic and economic rational is based on the principle of substitution--specifically that buyers and sellers had alternative of nearly equal acceptability, or sentiment, not to mention access to cash capital and freedom from irritation and duress.
1. MARKET COMPARISON methods are preferred, but the appraisal profession has found it difficult to develop objective methods for neutralizing differences and selecting properties objectively.
 2. The INCOME APPROACH is schizophrenic as to whether it is measuring economic productivity, the sum of liability, or the change in spendable cash for ownership through control of property rights.
 3. The COST APPROACH has moved from unethical according to the National Association of Realtors (NAR) in 1925, to pivotal in 1935, to embarrassing in 1985 since no one is sure if fiduciary responsibility requires a cost approach to avoid a sin of omission in the event of unforeseen disputes about value.
- F. However, none of these methodologies as logic systems structure the behavioral process required of the appraiser and his client. The client assumes that the task is defined when you ask for an appraisal and the appraiser assumes the client understands the rationale and appropriate application of fair market value or probable price. Both are more concerned with form than the substance of careful recognition of the problem for which the appraisal will serve as a benchmark. The problem suggests:
1. Objective appraisal
 - a. Validate purchase price as appropriate.
 - b. Identify change in price over time, if any.
 - c. Independent inspection of property and review of property management effectiveness.
 - d. Liquidating value of asset currently.
 - e. Future value of present assets.
 - f. Historical return on investment or future return on investment, real or nominal.
 2. Definition of value to be sought
 - a. Alternative definitions of value and related assumptions.

- b. Which definition of value is to be applied to which problem?
 - c. Market value vs. probable price. (Exhibit 1)
3. Definition of assets to be valued
- a. Property rights to be appraised.
 - b. Accounting rules to defining assets, collectively (going concern) or individually (liquidating).
4. Definition of methods to be used
- a. What constitutes comparative market data?
 - b. What constitutes objective market comparisons?
 - c. What constitutes an income approach to value?
 - d. Relevance of the cost approach to appraisal and appraisal adjustments.
 - e. Which appraisal methods are appropriate to which appraisal functions?
5. Definition of elements income approach
- a. Cash or accrual accounting.
 - b. Going concern value or value attributed to land and buildings.
 - c. Accounting rules for income.
 - d. Forecasting rules for changing income and expenses.
 - e. Estimating rules for changing income and expenses.
 - f. Provision for resale cost.
 - g. Conformity with historical pattern and leases in place for project.
6. Definition of appraiser/client relationship
- a. Who was considered an independent observer?
 - b. Frequency of appraisal.
 - c. Who was the arbiter of methods for integrating information into cohesive standardized formats suitable for measuring comparative performance?

III. Ironically, quality control of the appraisal process is in the hands of the customers for appraisal services, specifically those who stand to lose by permitting current conditions to continue. Historically, reform of the appraisal process has always been in the control of the customer who invests or guarantees real estate capital.

- A. Historical origins of the three approaches

1. The cost approach and the life insurance industry.
 2. The income approach and academia and the FHA.
 3. The market approach and the National Association of Realtors.
- B. Standardized reporting requirements of the American Institute of Real Estate Appraisers begin with Canon 5 of their Code of Ethics and is provided in Exhibit 2.
1. The Institute has never issued white papers on specific appraisal problems to standardize professional response to changing issues of common interest.
 2. The Institute doubts if it is cost-effective to develop special standards for those who do pension work if only 150-200 of its 6,000 members have substantial business responsibility.
 3. Recently the Institute has tried to issue white papers as guidelines, and a sample of such an effort is provided in Exhibit 3.
- C. More recent efforts at quality control include:
1. The Home Loan Bank redirecting appraisal attention to R-41-b. (Exhibit 4).
 2. FNMA and FHLBMC and requirements for appraising multi-family development.
 3. Residential form appraisals for FNMA, VA, FHA, and FHLBMC.
- D. The Royal Institute of Chartered Surveyors and the European Common Market Accountants have been developing a standardized language and procedure for the valuation of and reporting balance sheet assets. (See Exhibits 5, 6, 7, 8.)
- E. Requirements for developing consistent appraisal performance standards for pension programs requires a six-step process:
1. Development of a written policy statement by pension fund trustees relative to reporting of real estate asset values by money managers responsible for real estate.
 2. A written appraisal standard followed by a specific real estate fund manager's report covering both minimum standards shared with an association of managers and unique features

believed to provide better communication to fund trustees of important underlying facts and assumptions inherent in the appraisals.

3. A standard letter of engagement when contracting for appraisal services implementing the written policies of sponsor and money manager.
 4. A standard procedure for in-house appraisal reviews in the interim between independent outside appraisal reviews, including tolerance for variance before reporting changed values.
 5. Auditing and monitoring of appraisal reports by specially trained, CPA reviewers as part of the accounting audit process.
 6. Spot checking of appraisal procedures and a review process for disapproval of appraisal firms found to be likely of misinformation or misapplication of technique by ERISA.
- F. An early effort at appraisal control was a Letter of Engagement used at First Asset Realty Advisors (FARA) together with knowledgeable efforts to select the best local assessors. (See Exhibit 9).
1. The best appraisers are difficult to pick by reputation as the big names delegate their work to apprentices.
 2. Some appraisers admit to being intimidated and avoiding the assignment or charging extra for the assignment, anticipating that FARA will be more demanding.
 3. On balance, we are getting better appraisals than most of the funds we have seen in our research at a higher average cost.
- G. The FARA letter was followed by an effort by the National Council of Real Estate Investment Fiduciaries (NCREIF) to develop guidelines and the result of that effort currently is shown by Draft #2 in Exhibit 10.
1. NCREIF Committee dominated by Prudential accounting firm.
 2. It concluded that standardization was not possible without review of a broad range of appraisals throughout various sectors of the industry.
 3. Many of the NCREIF Committee felt that empirical investigation of the appraisal practices might

discourage the utilitarian use of real estate in a pension portfolio and opposed independent study.

H. Appraisal standards are ultimately the responsibility of those funding the pension program and directing the money manager, rather than any failure by the appraisal profession. The profession has always done what it is paid to do and if its tasks were not fully defined, that is because it served the purposes of the customer who was ambiguous. The pension sponsors must determine what they are willing to pay for relevant appraisal value in terms of:

1. Frequency, quality, and independence.
2. Parameters for market comparison or inference.
3. Responsibility for structural and mechanical engineering integrity.
4. Accounting issues for income projection and discounting.
5. Relevance of cost approach.
6. Comprehensive interpretation of fiduciary responsibilities and relationship to appraiser.

EXHIBIT 1

DEFINITION OF MARKET VALUE
AND
MOST PROBABLE PRICE

CURRENT OFFICIAL DEFINITION OF FAIR MARKET VALUE

The most probable price in cash, terms equivalent to cash, or in other precisely revealed terms, for which the appraised property will sell in a competitive market under all conditions requisite to fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.

Fundamental assumptions and conditions presumed in this definition are

1. Buyer and seller are motivated by self-interest.
2. Buyer and seller are well informed and are acting prudently.
3. The property is exposed for a reasonable time on the open market.
4. Payment is made in cash, its equivalent, or in specified financing terms generally available for the property type in its locale on the effective appraisal date.
5. The effect, if any, on the amount of market value of atypical financing, services, or fees shall be clearly and precisely revealed in the appraisal report. [1]

[1] American Institute of Real Estate Appraisers, The Appraisal of Real Estate, Eighth Edition, Chicago, IL, 1983, p. 33.

CONTEMPORARY DEFINITION OF MOST PROBABLE PRICE

"Most Probable Selling Price", as defined by Professor Richard U. Ratcliff:

The most probable selling price is that selling price which is most likely to emerge from a transaction involving the subject property if it were exposed for sale in the current market for a reasonable time at terms of sale which are currently predominant for properties of the subject type. [1]

[1] Unpublished quotation, Richard U. Ratcliff speaking on his book Valuation for Real Estate Decisions, Santa Cruz, CA, Democratic Press, 1972.

EXHIBIT 2

REPORTING REQUIREMENTS OF THE
AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS

4

Reporting Requirements of the American Institute of Real Estate Appraisers

Canon 5 of AIREA Regulation 10 (Code of Professional Ethics and Standards of Professional Conduct) establishes the minimum requirements for both written and oral appraisal reports prepared by members and candidates of the Institute. The explanatory comments for Canon 5 state:

The Institute requires its Members, in arriving at an analysis, conclusion or opinion concerning real estate, to employ all of the recognized appraisal methods and techniques that will materially contribute to a proper evaluation of such real estate or to a solution of the real estate problem under consideration. As a corollary to this rule, the Institute also requires that the appraisal process contain a clear statement of all of the assumptions made, together with a reasonably complete summary of the work done in arriving at each analysis, conclusion or opinion concerning real estate contained in the report. . . . A Member of the Institute must preserve his or her supporting data relating to a written appraisal report.

There are a number of specific reporting rules; some are obligatory and others are recommendations that should be followed unless there are substantial reasons, disclosed in the report, for not doing so.

PROPERTY DESCRIPTION

A clear and reasonably complete description of the property may include the street address, legal description, ownership, building name, and any other information that will assist in identifying the property. The identification may be part of the larger property description section of the report or a separate one- or two-sentence capsule included in the introduction to the report.

Property Identification

A complete address may suffice for a conforming residential property. For other properties an address should be included if one is available; if there have been recent changes in the street names or numbering schemes, both the present and prior addresses should be included. If the property is a vacant lot, the property address might be "the lot lying between or adjacent to" a property with an assigned street address. If only a part of the

address is the subject of the report, or if the report covers a project identified by the address plus adjacent excess land, the address portion of the property identification should make this clear. For example:

1250 Sleepy Hollow Lane
Centerland, California 92660

1250 Sleepy Hollow Lane
(previously known as 940 Tallow Street)
Centerland, California 92660

The 50' by 120' lot situated between
1050 and 1056 Main Street
Centerland, California 92660

456 Main Street
Centerland, California 92660
except for the rear 75 feet of
that address facing on the alley

320 Main Street
Centerland, California 92660
plus the rear 75 feet of
318 Main Street

Legal Description

A legal description of the property, if available, should be included. A reasonably short description can be included in the body of the report; a lengthy legal description may be placed in the addenda. If the description is at all complex, it is advisable to provide the source of the description—e.g., deed, title policy, assessor's records, or record of survey. If a legal description is not available, the report should say so and a clear map identifying the property should be included in the report. For example:

Lot 23 of Tract 4630 per map recorded in Page 23 of Book 4215 on July 15, 1957, in the Official Records of Simon County.

Exhibit B in the Addenda of this report contains a metes and bounds legal description as it appeared on the Grant Deed transferring ownership of the subject property to the Cowly Corporation on July 15, 1978.

As of the date of this appraisal, a legal description conforming to the portion of the Smith Ranch that is the subject of this appraisal had not been prepared. The subject property is outlined in red on the map labeled "Plat of Land" on page 23 of this report. It is assumed that a legal description that is adequate for the transfer of real property and that conforms to the property delineated on this map will be prepared.

Ownership data assist in the clear identification of property. For example:

The subject property consists of that 42.5 acres of vacant unimproved land which was acquired by Mr. Frank L. Smith on December 30, 1979, by Grant Deed recorded in Page 1521, Book 43762 of Deeds, in the Collins County Courthouse.

Even if there is a six-page detailed description of the property elsewhere in the report, the property identification and description portion is enhanced by a concise description of the property, such as:

The subject property is a six-year-old, three-story office building containing 24,320 square feet of gross building area. It is located on a 52,320-square foot parcel of land with 126 feet of frontage on Main Street.

STATEMENT OF FACTS, CONDITIONS, AND ASSUMPTIONS

It is good business practice for the appraiser and the client to agree in advance on the assumptions and limiting conditions that will apply to the report. Many appraisers include a copy of assumptions and limiting conditions with the appraisal proposal or contract. This portion of the report sets forth not only general assumptions and conditions that would apply to every report, but also any specific assumptions that apply to the particular appraisal.

Some assumptions and limiting conditions make a report a limited appraisal report; in such cases, there are additional requirements, which will be discussed and illustrated later in this chapter.

STATEMENTS RELATIVE TO NEIGHBORHOOD DECLINE

All written appraisal reports concerning residential real estate that state that a neighborhood is undergoing decline or is about to undergo decline must contain the specific facts or reasoning from which the opinion or conclusion of neighborhood decline is drawn.

DATE OF VALUE

The date of value is usually included in the letter of transmittal, in the introductory section of the report, and in the concluding valuation statement. This date is not to be confused with the date the transmittal letter was prepared, the date the assignment was started, or the date of inspection. Any or all of these dates may be the same as the date of value, but they usually are not. The only mandatory date is the date of value, but good business practice dictates that other significant dates also be identified, e.g., the transmittal date (the date the completed report is transmitted to the client), the date of inspection, the date of verification, and the date of photographs.

REASONING THAT SUPPORTS THE VALUATION

Unless the appraisal report is a limited report—one that does not show all of the appraiser's reasoning—and has been properly qualified as such, the reader must be able to follow the appraiser's thought processes from the data presented to the conclusions formed. A "limited report" must comply with the special requirements of a limited report (see pp. 27-28).

SPECIAL DISCLOSURES

Fractional Interests

All appraisal reports that involve a valuation of a fractional interest, i.e., less than the whole fee simple estate, must clearly state that the value reported relates only to a fractional interest in the real estate involved, and that the value of this fractional interest plus

the value of all other fractional interests may or may not equal the value of the entire fee simple estate. Typically, this is included in the statement of assumptions and limiting conditions. A common example is a report of a leasehold interest appraisal. The qualifying statement is required to demonstrate to the reader that the sum of the lessor's and lessee's interests is not necessarily equal to the fee simple estate.

Larger Parcel

All appraisal reports relating to the valuation of a geographic portion of a larger parcel or tract of real estate must clearly state that the value reported is for that portion only and should not be construed as applying with equal validity to other portions of the larger parcel or tract. In addition, it must be clear that the value reported for the portion plus the value of all other geographic portions may or may not equal the value of the entire parcel or tract. This statement typically appears in the assumptions and limiting conditions section of the report.

Personal Interest or Bias

All written appraisal reports must state that the appraiser has no present or contemplated future interest in the property appraised, and that the appraiser has no personal interest or bias with respect to the subject matter or the parties involved in the appraisal. If a statement of this nature cannot be made, the report must clearly and frankly disclose all such personal interest or bias.

PROFESSIONAL CONTRIBUTION OF OTHERS

Written appraisal reports are to acknowledge the professional contributions of others in arriving at the analyses, conclusions, or opinions concerning real estate contained in the appraisal report or state that no one other than the person or persons signing the report prepared the analyses, conclusions, and opinions therein.

If several professional appraisers work on a report, and all agree to and sign it, they include a statement similar to the following in their certificate:

No one other than the appraisers whose signatures appear below has prepared the analyses, conclusions, and opinions concerning real estate which are included in this report.

If the appraisers were assisted by a cost estimator who worked only on the cost portion of the report, they may use something similar to the following:

The assistance of John A. Doe, who prepared the cost estimate used in this report, is acknowledged. Except for Mr. Doe's assistance, no one other than the appraisers whose signatures appear below prepared the analyses, conclusions, and opinions concerning real estate which are included in this report.

If another appraiser, who asks not to be identified because of personal or policy considerations, was consulted and contributed substantially to the report, the statement might be:

The assistance and counsel of another appraiser not employed by this firm and who

requests that he not be identified is hereby acknowledged. Except for this appraiser's assistance, no one other than the undersigned prepared these analyses, conclusions, and opinions concerning real estate contained in this report.

Canon 5 does not require a member of the Institute to acknowledge assistance received in obtaining the data on which the appraisal report is based, assistance received in the physical preparation of the report (e.g., taking photographs; preparing charts, maps, or graphs; or typing or printing), or any other assistance that does not directly involve the exercise of judgment in arriving at the analyses, opinions, or conclusions concerning real estate.

The rule requiring acknowledgment of the professional contributions of others does not reduce the responsibility of those who sign a written appraisal report; in evaluating such reports, clients, mortgage lenders, and other users are entitled to rely on the signatures of all who sign. Therefore, although others may participate in the preparation of a written appraisal report, any member of the Institute who signs or cosigns a report must accept responsibility for the contents of the entire report.

PUBLIC DISCLOSURE

The recommended public disclosure statement of the Institute's Code of Ethics (Canon 7, Regulation 10) is:

Disclosure of the contents of this report is governed by the Bylaws and Regulations of the American Institute of Real Estate Appraisers of the National Association of Realtors. Neither all nor any part of the contents of this report (especially any conclusions as to value, the identity of the appraiser or any reference to the American Institute of Real Estate Appraisers or to the MAI or RM designation) shall be disseminated to the public through advertising media, public relations media, news media, sales media or any other public means of communication, without the prior written consent and approval of the author.

This statement is meant to preclude the potential misuse of the Institute's name and professional designations that can arise when a member's client elects to publicize the results of an appraisal report. Excessive or exploitative use of designations, sometimes out of appropriate context, does not serve the interests of the Institute, which its members should seek to protect. A client may be inclined to excerpt or quote portions of the report in promotional literature, and such practices are a potential source of great damage.

The language of a report can be misquoted, used out of context, or printed without reference to the assumptions or limiting conditions contained in the report, and may thus give a false impression of the report, the appraiser, or the profession. Although the specific use of a report is generally a matter of negotiation between the appraiser and the client, the Institute encourages its members to be aware of potential abuses and, whenever possible, to include appropriate contractual restrictions on a client's freedom to reproduce or republish an appraisal report.

CERTIFICATE

According to the Institute's Code of Ethics, all written reports must contain a certificate substantially in the following form:

I (we), the undersigned, do hereby certify that I (we) have (or have not) inspected the subject property and that to the best of my (our) knowledge and belief, the statements

of fact contained in this report, upon which the analyses, opinions, and conclusions expressed herein are based, are true and correct; also, this report sets forth all of the limiting conditions affecting the analyses, opinions, and conclusions contained in this report; also, this report has been made in conformity with and is subject to the requirements of the Code of Professional Ethics and Standards of Professional Conduct of the American Institute of Real Estate Appraisers of the National Association of Realtors.

The American Institute of Real Estate Appraisers conducts a voluntary program of continuing education for its designated members. MAIs and RMs who meet the minimum standards of this program are awarded periodic educational certification.

One of the following statements also must be included:

I am certified under this program through_____.

I was last certified under this program through_____.

I have not been certified under this program.

LIMITED APPRAISAL AND REPORT

A distinction is made between a limited appraisal, as defined by Canon 4 of Institute Regulation 10, and a limited report, as defined by Canon 5 of Regulation 10. In Canon 4 limitations on the scope of the appraisal process are treated; in Canon 5 limitations on the completeness of the report are addressed.

A limited appraisal could consist of an investigation and analysis that do not meet the requirements of established procedures of the Institute. For example, when a limited time schedule is required by the client, portions of the investigation and analysis may be curtailed or omitted. One of the approaches to value that would normally be included may be omitted, or certain reasonable assumptions may be made relative to highest and best use without the full investigation normally undertaken. However, before an appraiser can accept and perform such an assignment, three important requirements must be met.

1. Prior to accepting a limited assignment, the member must advise the client that the assignment calls for something less than the work required for a full and complete appraisal and that the appraisal report will be qualified to reflect the limited scope of the assignment.
2. The limited scope of the assignment must be sent forth in the appraisal report (and in any testimony concerning the appraisal) in a clear, precise manner.
3. The scope of the assignment must not be so limited that the results obtained are meaningless or could mislead the client or the public.

These requirements deal with a limitation on the scope of the appraisal process; Canon 5 deals with a limitation on the completeness of the report. It is quite possible that a complete investigation and analysis were undertaken but, by prior agreement, only the conclusions are set forth and the data and reasoning are retained in the appraiser's file. The result is what is typically referred to as a letter report (see Chapter 5).

Although part or all of the data and reasoning can be omitted, the following must be included: the certificate of appraisal, an adequate identification of the property, a date of value, the required limiting conditions referred to in the certificate of appraisal statement, acknowledgment of the contributions of others, and the statement of nonbias. To omit any of these items would make the report meaningless or misleading.

A limited report must meet the same three conditions listed above for a limited appraisal. There are also requirements for preparing an expanded appraisal report, which contains more than is required by Institute standards. In these cases, the same three rules apply.

The first condition of prior client advice is best met by an agreement in writing. This can be part of the proposal letter or can be contained in a specific instruction from the client or the attorney of the client.

THE EVALUATION REPORT

The preface to the Institute's Regulation 10 clearly states that it applies to both valuation and evaluation reports. The word *valuation* is used to refer to the estimate of the value of a particular parcel of real estate at a particular point in time. The word *evaluation* is used in the broader sense as an evaluation of the nature, quality, or utility of any parcel of real estate. Examples of evaluation reports include marketability studies, feasibility reports, land-use studies, investment decision analyses, and cost-benefit studies.

When the reporting rules of Canon 5 apply to valuation assignments only, the qualifying phrase "a valuation of a particular parcel or tract of real estate" is used. In all other instances, the reporting rules apply equally to evaluation and valuation reports as do the general considerations of good communication.

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The Letter Report

In some instances, by prior agreement with the client, the appraiser will submit the results of an appraisal in letter form. As described in the preceding chapter, this type of report generally sets forth only the conclusions of the appraiser's investigations and analyses. Although much of the data and reasoning is omitted from the letter, the following items must be included to make the report meaningful: the certificate, adequate identification of the property, the date of value, limiting conditions, acknowledgment of the contributions of others, and a statement of nonbias.

Example 5.1 offers a typical letter report, documenting the appraisal of a mobile home park.

EXAMPLE 5.1. Letter of Opinion

(Appraiser's Letterhead)

August 25, 1981

Mr. Harold S. Huntington
Trans-Atlantic Factors
2082 Murphy Drive, Suite 300
Irvine, California 92715

Re: Appraisal of 274-Space Mobile Home Park
3200 Fedlow Road
San Jose, California

Dear Mr. Huntington:

Upon your authorization, we have conducted the investigations and analyses necessary to form an opinion of the market value of the fee simple interest in the mobile home park located at 3200 Fedlow Road in the City of San Jose.

The opinions set forth in this letter are stated as of July 15, 1981.

The term "market value" is defined as:

The highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.

The analyses and opinions in this letter are subject to the following premises, assumptions, and limitations:

Per the request of the client, this appraisal is limited in that the only approach to value used is the income approach. Market data and reasoning supporting our analyses, conclusions, and opinions have been retained in our files.

Based upon these investigations and analyses, and upon our experience as real estate appraisers, we have reached the opinion that the subject, as of July 15, 1981, has a market value of:

THREE MILLION SIX HUNDRED THOUSAND DOLLARS
(\$3,600,000)

Mr. Lafferty certifies that, during the completion of the assignment, he has personally inspected the property that is the subject of this report. Ms. Sullivan has not inspected the property.

The undersigned hereby certify that, except as specifically noted:

1. We have no present or contemplated future interest in the real estate or personal interest with respect to the subject matter or the parties involved in this appraisal letter, and our employment in this matter is not in any manner contingent upon anything other than the delivery of this report.
2. To the best of our knowledge and belief, the statements of fact contained in this appraisal letter, upon which the analyses, opinions, and conclusions expressed herein are based, are true and correct.
3. This appraisal letter sets forth all of the limiting conditions (imposed by the terms of our assignment

continued

or by the undersigned) affecting the analyses, opinions, and conclusions contained in this report.

4. This appraisal letter has been made in conformity with, and is subject to, the requirements of the Code of Professional Ethics and Standards of Professional Conduct of the American Institute of Real Estate Appraisers of the National Association of Realtors.
5. We alone have prepared the analyses, opinions, and conclusions concerning real estate that are set forth in this appraisal letter.

Disclosure of the contents of this appraisal letter is governed by the Bylaws and Regulations of the American Institute of Real Estate Appraisers of the National Association of Realtors. In furtherance of the aims of the Institute to develop higher standards of professional performance by its members, the appraisers may be required to submit to authorized committees of said Institute copies of this report and any subsequent changes or modifications thereof.

Respectfully submitted,

Charles W. Lafferty
Ruth V. Sullivan, MAI

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The Form Report

Many lending institutions and certain government agencies prefer a form report to a narrative report. This is particularly true for single-family residential appraisals. The form appraisal is preprinted with a combination of check-off boxes and blank lines for insertion of words or short comments.

The advantage of a form report is that the review appraiser knows exactly where to find all essential elements of the report and can do so quickly and efficiently. The disadvantage is that the appraisal problem is frequently not suited to the form. If special analyses or discussions are required, the form must be supplemented with attachments, which must be cross-referenced to specific sections of the form.

For Institute members and candidates, a form report must meet the reporting requirements of the Institute or otherwise qualify as a limited report under the conditions set forth in Canon 5 of Regulation 10.

A sample of a form report appears on the following pages.

EXAMPLE 6.1 FNMA-FHLMC Form Appraisal

RESIDENTIAL APPRAISAL REPORT File No

Borrower _____ **County** Cook **Map Reference** _____

Property Address 7340 Halesia **City** Parkside **State** IL **Zip Code** 60062

Legal Description _____

Sale Price \$ _____ **Date of Sale** _____ **Loan Term** _____ **Property Rights Appraised** Fee Leasehold DeMinimis PUD

Actual Real Estate Taxes \$ _____ **1yr/1 Loan charges to be paid by seller \$** _____ **Other sales concessions** _____

Lender/Client Michael Haber/Fred Heiss **Address** _____

Occupant Mr. & Mrs. Ayron **Appraiser** _____ **Instructions to Appraiser** _____

Location Urban Suburban Rural

Built Up Over 75% 25% to 75% Under 25%

Growth Rate Fully Dev Rapid Steady Slow

Property Values Increasing Stable Declining

Demand/Supply Shortage In Balance Over Supply

Marketing Time Under 3 Mos 4-6 Mos Over 6 Mos

Present Land Use 60% % 1 Family 2 % 2-4 Family 10 % Apts 10 % Condo _____ % Commercial

Change in Present Land Use Industrial 20 % Vacant _____ %

Predominant Occupancy Owner Tenant _____ % Vacant _____ %

Single Family Price Range \$ 80,000 to \$ 130,000 **Predominant Value** \$ 110,000

Single Family Age 1 yrs to 10 yrs **Predominant Age** 5-7 yrs

Employment Stability Good Fair Poor Very Poor

Convenience to Employment Good Fair Poor Very Poor

Convenience to Shopping Good Fair Poor Very Poor

Convenience to Schools Good Fair Poor Very Poor

Adequacy of Public Transportation Good Fair Poor Very Poor

Recreational Facilities Good Fair Poor Very Poor

Adequacy of Utilities Good Fair Poor Very Poor

Property Compatibility Good Fair Poor Very Poor

Protection from Detrimental Conditions Good Fair Poor Very Poor

Police and Fire Protection Good Fair Poor Very Poor

General Appearance of Properties Good Fair Poor Very Poor

Appeal to Market Good Fair Poor Very Poor

Notes: FHLMC/FNMA do not consider race or the racial composition of the neighborhood to be reliable appraisal factors. Comments including those factors, favorable or unfavorable, affecting marketability (e.g. public parks, schools, view, noise)

The subject is located near schools and church in a neighborhood consisting of well-maintained residences of similar quality and age.

Dimensions 70 ft. x 125 ft. (estimated) **Sq Ft** 8,750+ Corner Lot

Zoning classification Residential **Present improvements** do do not conform to zoning regulations

Highest and best use Present use Other (specify) _____

Electric Public Other (describe) _____ **Street Access** Public Private

Gas _____ **Surface** asphalt **Shape** Rectangular

Water _____ **Maintenance** Public Private **View** South-toward residential

San Sewer _____ **Storm Sewer** Curb/Gutter **Drainage** Appears adequate

Underground Elect & Tel Sidewalk Street Lights **Is the property located in a HUD identified Special Flood Hazard Area?** No Yes

Comments: favorable or unfavorable, including any apparent adverse easements, encroachments or other adverse conditions

No survey was furnished to the appraiser. All dimensions are approximate.

Existing Proposed Under Constr. **No Units** 1 **Type** Detached **Exterior Walls** By/Frame

Yrs. Age Actual 7 **Effective** 3 to 5 **No. Stories** 1+ **Roof** Asphalt shingle **Windows (Type)** Casement **Insulation** None Floor Ceiling Roof Wall

Roof Material Asphalt shingle **Basement** 0 % Finished Ceiling Finished Walls

Foundation Poured concrete **Outside Entrance** Sump Pump Finished Floor

Manufactured Housing **Concrete Floor** _____ % **Finished Floor** _____

Slab on Grade **Crawl Space** _____ **Evidence of** Dampness Termites Settlement

Comments: Lower level includes laundry room, family room, den and full bath. There is a fireplace in the family room. Finish consists of carpeting and paneling.

Room List	Foyer	Living	Dining	Kitchen	Den	Family Rm	Rec Rm	Bedrooms	No. Baths	Laundry	Other
1st Level						1	1		1	1	
2nd Level	1	1	1	1				4	2		

Finished area above grade contains a total of 7 rooms, 4 bedrooms, 2 baths, **Gross Living Area** 1,798+ sq. ft. **Basement Area** 0 sq. ft.

Kitchen Equipment Refrigerator Range/Oven Disposal Dishwasher Fan/Hood Compactor Washer Dryer

HEAT Type FA **Fuel** Gas **Cond** Good **AIR COND** Central Other Adequate Inadequate

Floors Hardwood Carpet Over _____

Walls Drywall Plaster _____

Trim/Finish Good Average Fair Poor

Bath Floor Ceramic _____

Bath Wainscot Ceramic _____

Special Features (including energy efficient items) _____

ATTIC Yes No Stairway Drop star Scuttle Floored

Finished (Describe) _____ Heated

CAR STORAGE Garage Built-in Attached Detached Car Por.

No. Cars 2+ Adequate Inadequate **Condition** Good

Quality of Construction (Materials & Finish) Good Fair Poor Very Poor

Condition of Improvements Good Fair Poor Very Poor

Room sizes and layout Good Fair Poor Very Poor

Chimney and Stove Good Fair Poor Very Poor

Insulation - adequacy Good Fair Poor Very Poor

Plumbing - adequacy and condition Good Fair Poor Very Poor

Electrical - adequacy and condition Good Fair Poor Very Poor

Kitchen Cabinets - adequacy and condition Good Fair Poor Very Poor

Compatibility to Neighborhood Good Fair Poor Very Poor

Overall Usability Good Fair Poor Very Poor

Appraisal and Marketability Good Fair Poor Very Poor

Yrs. Est. Remaining Economic Life 50 to 60 **Explain less than 50 Yrs.** _____

FIREPLACES, PATIOS, POOL, FENCES, etc. (describe)

Fireplace in family room; patio in rear.

COMMENTS: including functional or physical inadequacies, repairs needed, modernization, etc.

No inadequacies noted.

FHLMC Form 70 Rev. 7/78

ATTACH DESCRIPTIVE PHOTOGRAPHS OF SUBJECT PROPERTY AND STREET SCENE

FNMA Form 1004 Rev. 7/78

continued

VALUATION SECTION

Purpose of Appraisal is to estimate Market Value as defined in Certification & Statement of Limiting Conditions (FHLMC Form 438/FNMA Form 1004B). If submitted for FNMA, the appraiser must attach (1) sketch or map showing location of subject, street names, distance from nearest intersection, and any detrimental conditions and (2) exterior building sketch of improvements showing dimensions.

Measurements	No. Stories	Sq. Ft.	ESTIMATED REPRODUCTION COST - NEW - OF IMPROVEMENTS:
29' x 26' = 1 = 754			Dwelling 1,798+ Sq. Ft. @ \$ 35.00 = \$ 62,930
29' x 36' = 1 = 1,044			LL. Fin. 1,044+ Sq. Ft. @ \$ 22.75 = 23,751
			Extra Central air = 1,500
			Fireplace = 1,500
			Special Energy Efficient Items
			Porches, Patios, etc. = 1,000
			Garage/Car Port 750 Sq. Ft. @ \$ 9.75 = 7,313
			Site Improvements (driveway, landscaping, etc.) = 2,000
			Total Estimated Cost New = \$ 99,994
			Less Physical Depreciation \$ 10,000 = \$ 89,994
			Less Functional Depreciation = \$ 25,000
			Less Economic Depreciation = \$ 25,000
			ESTIMATED LAND VALUE (If leasehold, show only leasehold value) = \$ 25,000
			INDICATED VALUE BY COST APPROACH = \$114,994

Total Gross Living Area (List in Market Data Analysis below) 1,798+

Comment on functional and economic obsolescence: No obsolescence noted.

The undersigned has reviewed three recent sales of properties most similar and proximate to subject and has considered these in the market analysis. The description includes a dollar adjustment, reflecting market reaction to those items of significant variation between the subject and comparable properties. If a significant item in the comparable property is superior to, or more favorable than, the subject property, a minus (-) adjustment is made, thus reducing the indicated value of subject. If a significant item in the comparable is inferior to, or less favorable than, the subject property, a plus (+) adjustment is made, thus increasing the indicated value of the subject.

ITEM	Subject Property	COMPARABLE NO. 1	COMPARABLE NO. 2	COMPARABLE NO. 3
Address	7540 Halesia	7637 E. Palm Ct. Parkside, IL	15423 S. Primrose Parkside, IL	15124 Lilac Lane Parkside, IL
Proximity to Subj.		less than 1/2 mile	less than 1/2 mile	less than 1/2 mile
Sales Price		\$ 118,500	\$ 114,000	\$ 120,000
Price/Living Area		\$ 64.40	\$ 63.33	\$ 63.69
Date of Sale and Time Adjustment		8-80	4-81	5-81
Location	Good			
Site/View	70 x 125	irr.	irr.	irr.
Design and Appeal	Split level			
Quality of Constr.	Br/Fr Good			
Age	7	6	5	7
Condition	Good			
Living Area Room Count and Total	Total: 8-rms, 2-baths 7 4 2	Total: 8-rms, 2-baths 7 4 2	Total: 6-rms, 2-baths 6 3 2 +2000	Total: 8-rms, 2-baths 7 4 2
Gross Living Area	1,798+ Sq. Ft.	1,840 Sq. Ft.	1,800+ Sq. Ft.	1,884 Sq. Ft.
Lower Level	2 rooms 1 bath		1 room 1 bath +2000	
Functional Utility	Good			
Air Conditioning	Central			
Garage/Car Port	2-car			
Porches, Patios, Pools, etc.	Patio			
Special Energy Efficient Items				
Other (e.g. fireplaces, kitchen equip., remodeling)	1-fireplace	None +1500		
Sales or Financing Concessions		Conventional	Conventional	Conventional
Net Adj. (Total)		\$ Plus, \$ Minus \$ 1,500	\$ Plus, \$ Minus \$ 4,000	\$ Plus, \$ Minus \$ -0-
Indicated Value of Subject		\$ 120,000	\$ 118,000	\$ 120,000

Comments on Market Data: All comps. are located in same neighborhood and are very similar. No time adjustment indicated. Financing concessions may affect the sale prices and are not reported.

INDICATED VALUE BY MARKET DATA APPROACH = \$ 120,000

INDICATED VALUE BY INCOME APPROACH (If applicable) Economic Market Rent \$ _____ Mo. x Gross Rent Multiplier _____ = \$ _____ R/A

This appraisal is made as is subject to the repairs, alterations, or conditions listed below completion per plans and specifications.

Comments and Conditions of Appraisal: See attached sheet. No survey furnished the appraiser; all dimensions are approximate.

Final Reconciliation: Market approach most indicative of buyer and seller reactions in marketplace.

Construction Warranty Yes No Name of Warranty Program _____ Warranty Coverage Expires _____

This appraisal is based upon the above requirements, the certification, contingent and limiting conditions, and Market Value definition that are stated in FHLMC Form 438 (Rev. 10/78)/FNMA Form 1004B (Rev. 10/78) filed with client _____ 19 _____ attached.

ESTIMATE THE MARKET VALUE, AS DEFINED, OF SUBJECT PROPERTY AS OF October 24, 1981 to be \$ 120,000

Appraiser: _____ Review Appraiser (if applicable) Did Did Not Physically Inspect Property

continued

DEFINITION OF MARKET VALUE: The highest price in terms of money which a property will 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: (1) buyer and seller are typically motivated; (2) both parties are well informed or well advised, and each acting in what he considers his own best interest; (3) a reasonable time is allowed for exposure in the open market; (4) payment is made in cash or its equivalent; (5) financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale; (6) the price represents a normal consideration for the property sold unaffected by special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction. ("Real Estate Appraisal Terminology," published 1975.)

CERTIFICATION AND STATEMENT OF LIMITING CONDITIONS

CERTIFICATION: The Appraiser certifies and agrees that:

1. The Appraiser has no present or contemplated future interest in the property appraised; and neither the employment to make the appraisal, nor the compensation for it, is contingent upon the appraised value of the property.
2. The Appraiser has no personal interest in or bias with respect to the subject matter of the appraisal report or the participants to the sale. The "Estimate of Market Value" in the appraisal report is not based in whole or in part upon the race, color, or national origin of the prospective owners or occupants of the property appraised, or upon the race, color or national origin of the present owners or occupants of the properties in the vicinity of the property appraised.
3. The Appraiser has personally inspected the property, both inside and out, and has made an exterior inspection of all comparable sales listed in the report. To the best of the Appraiser's knowledge and belief, all statements and information in this report are true and correct, and the Appraiser has not knowingly withheld any significant information.
4. All contingent and limiting conditions are contained herein (imposed by the terms of the assignment or by the undersigned affecting the analyses, opinions, and conclusions contained in the report).
5. This appraisal report has been made in conformity with and is subject to the requirements of the Code of Professional Ethics and Standards of Professional Conduct of the appraisal organizations with which the Appraiser is affiliated.
6. All conclusions and opinions concerning the real estate that are set forth in the appraisal report were prepared by the Appraiser whose signature appears on the appraisal report, unless indicated as "Review Appraiser." No change of any item in the appraisal report shall be made by anyone other than the Appraiser, and the Appraiser shall have no responsibility for any such unauthorized change.

CONTINGENT AND LIMITING CONDITIONS: The certification of the Appraiser appearing in the appraisal report is subject to the following conditions and to such other specific and limiting conditions as are set forth by the Appraiser in the report.

1. The Appraiser assumes no responsibility for matters of a legal nature affecting the property appraised or the title thereto, nor does the Appraiser render any opinion as to the title, which is assumed to be good and marketable. The property is appraised as though under responsible ownership.
2. Any sketch in the report may show approximate dimensions and is included to assist the reader in visualizing the property. The Appraiser has made no survey of the property.
3. The Appraiser is not required to give testimony or appear in court because of having made the appraisal with reference to the property in question, unless arrangements have been previously made therefor.
4. Any distribution of the valuation in the report between land and improvements applies only under the existing program of utilization. The separate valuations for land and building must not be used in conjunction with any other appraisal and are invalid if so used.
5. The Appraiser assumes that there are no hidden or unapparent conditions of the property, subsoil, or structures, which would render it more or less valuable. The Appraiser assumes no responsibility for such conditions, or for engineering which might be required to discover such factors.
6. Information, estimates, and opinions furnished to the Appraiser, and contained in the report, were obtained from sources considered reliable and believed to be true and correct. However, no responsibility for accuracy of such items furnished the Appraiser can be assumed by the Appraiser.
7. Disclosure of the contents of the appraisal report is governed by the Bylaws and Regulations of the professional appraisal organizations with which the Appraiser is affiliated.
8. Neither all, nor any part of the content of the report, or copy thereof (including conclusions as to the property value, the identity of the Appraiser, professional designations, reference to any professional appraisal organizations, or the firm with which the Appraiser is connected), shall be used for any purposes by anyone but the client specified in the report, the borrower if appraisal fee paid by same, the mortgagee or its successors and assigns, mortgage insurers, consultants, professional appraisal organizations, any state or federally approved financial institution, any department, agency, or instrumentality of the United States or any state or the District of Columbia, without the previous written consent of the Appraiser, nor shall it be conveyed by anyone to the public through advertising, public relations, news, sales, or other media, without the written consent and approval of the Appraiser.
9. On all appraisals, subject to satisfactory completion, repairs, or alterations, the appraisal report and value conclusion are contingent upon completion of the improvements in a workmanlike manner.

Julie Miller
 Julie Miller, Appraiser

REVIEWED AND APPROVED BY:

James R. Webster
 James R. Webster, MAI

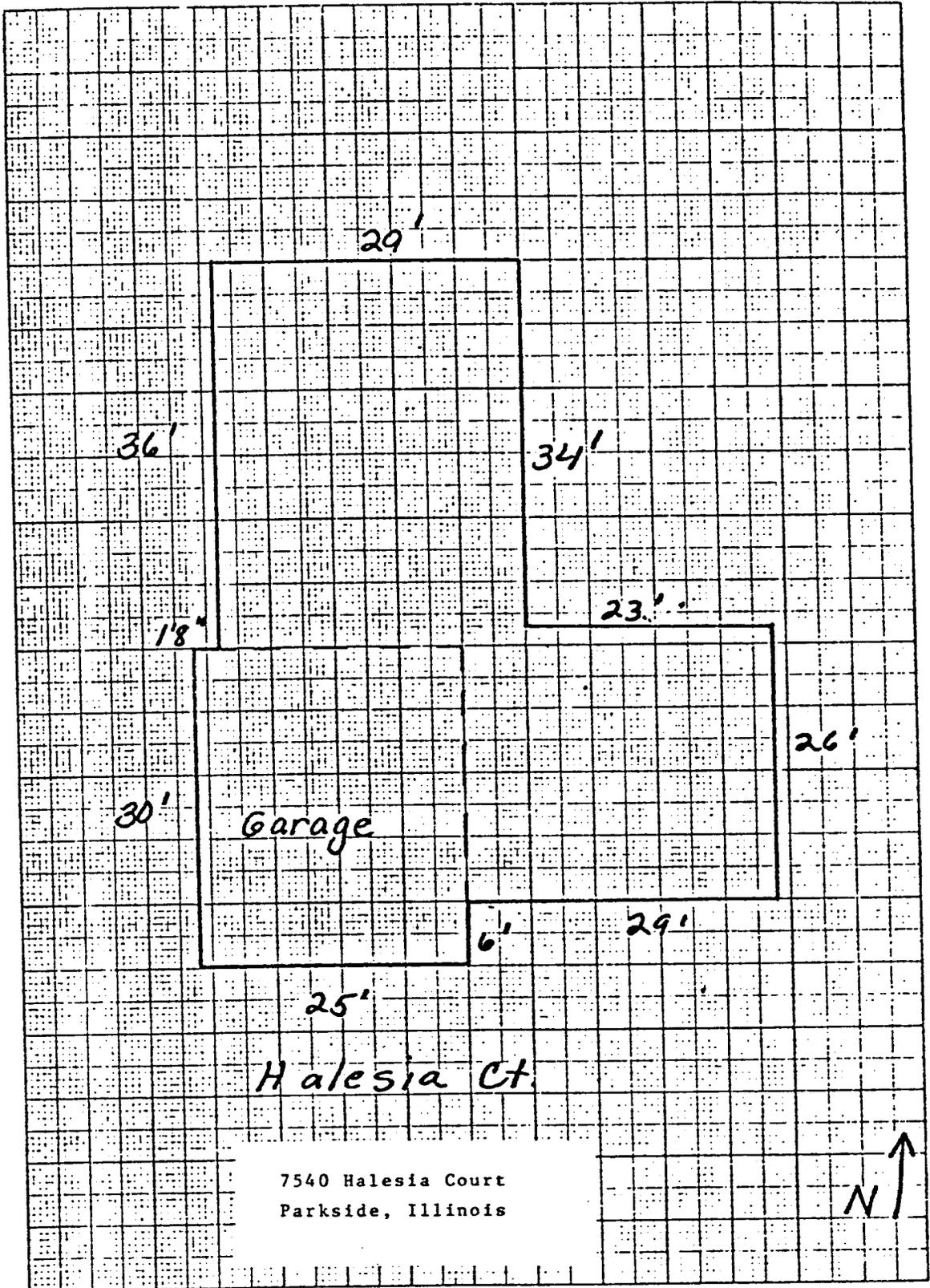
Date: October 24, 1981

PHLME FORM 1000 REV. 10/79

PHMA FORM 1000 REV. 10/79

continued

PROPERTY MAP



7

The Narrative Report

In a narrative appraisal report, the appraiser is afforded the best opportunity to present data and reasoning that support the conclusions reached. As stressed earlier, good organization is essential.

LETTER OF TRANSMITTAL

Transmittal letters introduce the report and present it to the client. A good transmittal letter should be concise and in compliance with accepted standards of business correspondence. It is useful to begin the letter with a reference to the terms and circumstances of the authorization of the assignment. Important points that may be included in a transmittal letter are:

1. Date of the letter (not necessarily or usually the same as the date of value).
2. Client name and address; if it is a corporate client, a reference to the individual who will receive the report should be included. Include the person's title.
3. A reference that will identify the property by name or street address and possibly a file or purchase order reference.
4. Appropriate salutation.
5. Reference to the authorization that initiated the assignment.
6. Reference to the inspection, investigation, and analyses undertaken by the appraiser for the purpose of forming an opinion of value.
7. A concise statement of the value conclusion and the date of value.
8. An indication that the value conclusion is subject to certain assumptions and limiting conditions set forth in the body of the accompanying report.
9. A clear reference that the letter itself is not the appraisal but that it merely serves to transmit the appraisal report that follows.
10. The signatures of all appraisers who bear responsibility for the analyses and conclusions within the report.

Some appraisers choose to incorporate the certificate of value within the transmittal letter; others choose to include it within the body of the report. A typical transmittal letter is presented in Example 7.1.

EXAMPLE 7.1. Transmittal Letter

(Appraiser's Letterhead)

May 13, 1981

Our File No. 758.3

Your Reference No. 8046-C-52

Universal Investment Company
123 Main Street
Middletown, CA 99990

Attn: Mr. William D. Jones, President

Re: Appraisal Report
Office Building at 300 Broad Street
Middletown, California

Gentlemen:

In response to your authorization letter of March 1, 1981, we have conducted the required investigation, gathered the necessary data, and made certain analyses that have enabled us to form an opinion of the market value of the fee simple interest in the above-captioned subject property.

Based on the inspection of the property and the investigation and analyses undertaken, we have formed the opinion that, as of April 8, 1981, and subject to the assumptions and limiting conditions set forth on page 8 of this report, the subject has a market value of:

FOUR MILLION SEVEN HUNDRED FIFTY THOUSAND DOLLARS
\$4,750,000

The narrative appraisal report that follows sets forth the identification of the property, the assumptions and limiting conditions, pertinent facts about the area and the subject property, comparable data, the results of the investigations and analyses, and the reasoning leading to the conclusions set forth.

Respectfully submitted,

Jane A. Adams
John B. Roe, MAI

INTRODUCTION TO REPORT

The opening section of the report sets forth the purposes and objectives of the appraisal, an identification of the property and the property rights appraised, and a definition and explanation of important concepts fundamental to the report. Many appraisers list the assumptions and limiting conditions of the report in this section.

Purpose of Report or Objective of Appraisal

The purpose of the report is to communicate the data and reasoning leading to a conclusion. The purpose of the appraisal, or objective of the assignment, is usually to arrive at a supportable opinion. In a simple assignment, the appraiser may express both ideas in a brief paragraph such as:

The objective of this appraisal is to estimate the market value of the City National Bank Building as of April 5, 1981. The purpose of this report is to present the data and reasoning that the appraiser has used to form the opinion of value.

Other, more complex appraisal assignments require a more detailed statement of the appraisal problem as illustrated in Example 7.2.

Property Rights Valued

If the assignment concerns the appraisal of a fee simple estate interest, it may be sufficient to describe the property rights in the statement of purpose. A separate statement may be required for more complex fractional interests.

Identification of Property

The property should be clearly and unambiguously identified by as many different means as possible, including:

1. Legal description (if lengthy, it may be put in the addenda and referred to within the identification section of the report).
2. Street address, including any qualifiers if the parcel is more or less than that encompassed by the street number.
3. Assessor's parcel number if numbers tend to remain the same from year to year in the jurisdiction involved.
4. Reference to the nearest intersection (e.g., "the parcel with 100 feet of frontage on the north side of Main Street, located 360 feet west of the centerline of the intersection of Main Street and Baldwin Avenue").
5. Reference to any common name for the property, such as the "City National Bank Building."
6. Identification by property type, such as "the three-story, wood-frame office building at the southwest corner of Pierce and Franholm Avenues."
7. Reference to ownership and transfer such as "the 20-acre portion of the southwest quarter of Section 15, Range 10 N. Township 5 S, transferred to Frank Smith by deed recorded November 10, 1980, in Book 3516; Page 431 of Official Records."

EXAMPLE 7.2. Statement of Objective

The objective of this appraisal assignment is to undertake the investigations and analyses required to reach four supportable estimates for each of the following premises:

Premise A

Assuming the lawsuit to overturn the county's approval of Environmental Impact Report No. 568 is unsuccessful and the joint venture is permitted to proceed with development of the Moonrise Bay Hotel and commercial project described herein,

- A-1. Estimate the market value of the site "as is."
- A-2. Estimate the market value of the project, assuming completion in accord with the plans and specifications identified and described herein.
- A-3. Estimate the market value of the project, assuming completion in accord with the plans and specifications identified and described herein and also assuming completion of the leasing of the commercial space at market rent levels.
- A-4. Estimate the amount of time after completion of construction for the commercial space to be leased.
- A-5. Estimate the occupancy level and average daily rate for the hotel during its first full year of operation and estimate the time after completion for the hotel to achieve stabilized occupancy

Premise B

Assuming the decision of the court is to sustain the Environment Alliances lawsuit to overturn Environmental Impact Report No. 568 on the basis of the arguments in their petition,

- B-1. Estimate the highest and best use of the subject site as is.
 - B-2. Estimate the market value of the subject site as is.
 - B-3. Estimate the highest and best use of the subject site as if joined with the adjacent 12.5-acre Coffin parcel described herein.
 - B-4. Estimate the market value of the subject site and the adjacent 12.5-acre Coffin site as if they were joined.
-

Ownership and Recent History

It is good practice to list current ownership and the date, price, and terms of acquisition. If there have been several transfers in recent years, it is also helpful to mention these. If the appraisal is of a parcel seriously encumbered by other rights created by easements or deed reservations, these must be clearly explained. Some corporations, lenders, and public agencies require a five- or ten-year property history as a part of their appraisal requirements. Salient facts can be enumerated as follows:

This appraisal is of the leasehold estate created by the ground lease executed December 31, 1947, between the Crafton Estate Company, as lessor, and the Loomis Company, as lessee. Through successive assignments of the leasehold interest, the leasehold estate is now vested in the name of Donbrow Realty Company, a California corporation. The lease and assignments of lease are reproduced as Exhibit D in the Addenda of this report. A synopsis and analyses of the lease begins on page 53 of this report.

Definitions of Significant Terms

Appraisal terms and legal concepts should be defined early in the report. In almost every instance, there should be a definition of *market value*, perhaps with a discussion of significant elements of the definition.

The appraiser should use the definition of market value appropriate to the particular assignment. In condemnation work, market value may be defined by statute or legal precedent in the jurisdiction involved. Assignments for lending institutions may require a definition imposed by one or more regulatory agencies. The appraiser may prefer to use the definition of market value in *Real Estate Appraisal Terminology*. Example 7.3 shows one way of presenting a definition of market value.

Other terms that may require definition include *highest and best use*, *market rent*, *market feasibility*, and, in condemnation work, *special benefits*, *severance damages*, *the part taken*, and *the larger parcel*. The authority or source of any definitions should be cited. Some appraisers incorporate the definitions in the "Assumptions and Limiting Conditions."

Assumptions and Limiting Conditions

Canon 5 of the Code of Professional Ethics and Standards of Professional Conduct of the American Institute of Real Estate Appraisers requires the appraiser to "clearly and unequivocally set forth all facts, assumptions and conditions upon which the appraisal is based." A variety of assumptions and limiting conditions might apply, depending on the appraisal. A list of those the appraiser may require appears in Example 7.4. Alternate wordings as used by different appraisers are given.

This section of the report may be called "Contingent and Limiting Conditions" or "Premises, Assumptions, and Limiting Conditions." Some appraisers prefer to place the entire section at the end of the report near the certificate of value. Others prefer to put specific conditions in the introductory section and general assumptions and limiting conditions at the end of the report. By placing all assumptions and limiting conditions early in the report, the reader is alerted to the premises underlying the data analysis and reasoning of the appraisal.

EXAMPLE 7.3. Market Value Definition and Implications

Market value is defined in *Real Estate Appraisal Terminology*¹ as:

"The most probable price in terms of money which a property should bring in 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:

- "1. buyer and seller are typically motivated.
- "2. both parties are well informed or well advised, and each acting in what they consider their own best interest.
- "3. a reasonable time is allowed for exposure in the open market.
- "4. payment is made in cash or its equivalent.
- "5. financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale.
- "6. the price represents a normal consideration for the property sold unaffected by special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction."

An understanding of the most likely segment of the investment submarket capable of bidding on the property is essential. Appraisers study and adopt the motivations of the potential buyer group which will exert the greatest pressure on the price structure.

1. American Institute of Real Estate Appraisers and Society of Real Estate Appraisers, *Real Estate Appraisal Terminology*, revised edition, ed. Byrl N. Boyce (Cambridge, Mass.: Ballinger Publishing Company, 1981), pp. 160-161.

EXAMPLE 7.4. Assumptions and Limiting Conditions**GENERAL CONDITIONS**

1. That the term *fair market value*, as herein used, is defined as "the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available" (Cal. Code of Civ. Proc., Title 7, Sec. 1263.320).
2. That the date of value to which the opinions expressed in this report apply is set forth in the letter of transmittal. The appraiser assumes no responsibility for economic or physical factors occurring at some later date which may affect the opinions herein stated.
3. That no opinion is intended to be expressed for legal matters or that would require specialized investigation or knowledge beyond that ordinarily employed by real estate appraisers, although such matters may be discussed in the report.
4. That no opinion as to title is rendered. Data on ownership and the legal description were obtained from sources generally considered reliable. Title is assumed to be marketable and free and clear of all liens and encumbrances, easements, and restrictions except those specifically discussed in the report. The property is appraised assuming it to be under responsible ownership and competent management and available for its highest and best use.
5. That no engineering survey has been made by the appraiser. Except as specifically stated, data relative to size and area were taken from sources considered reliable, and no encroachment of real property improvements is assumed to exist.
6. That maps, plats, and exhibits included herein are for illustration only, as an aid in visualizing matters discussed within the report. They should not be considered as surveys or relied upon for any other purpose.
7. That no opinion is expressed as to the value of subsurface oil, gas, or mineral rights and that the property is not subject to surface entry for the exploration or removal of such materials except as is expressly stated.

FOR COURT OR HEARING TESTIMONY

8. That testimony or attendance in court or at any other hearing is not required by reason of rendering this appraisal unless such arrangements are made a reasonable time in advance.
9. That, because the date of value used herein is the date of trial, the appraiser reserves the right to consider and evaluate additional data that become available between the date of this report and the date of trial and to make any adjustments to the value opinions that may be required.

FOR DISCLOSURE OF PROFESSIONAL ASSISTANCE

10. That, although the valuation contained in this report is the work product of the appraiser, specialized professional studies relating to the engineering cost estimate prepared by Frank L. Doe, Registered Land Engineer, have been relied on in formulating conclusions.

FOR DISCLOSURE OF PERSONAL INTEREST

11. That the appraiser acknowledges personal interest, limited to ownership of ten shares of stock in the American Telephone and Telegraph Company, in the subject of this appraisal, but concludes that such interest will not affect his professional judgment, and that he has made full disclosure of such interest to the client.

continued

FOR TITLE REPORT NONAVAILABILITY

12. That, because no title report was made available to the appraiser, she assumes no responsibility for such items of record not disclosed by her normal investigation.

FOR QUESTIONABLE SOIL OR GEOLOGIC CONDITIONS

13. That no detailed soil studies covering the subject property were available to the appraiser. Therefore, premises as to soil qualities employed in this report are not conclusive but have been considered consistent with information available to the appraiser.
14. That, since earthquakes are common in the area, no responsibility is assumed due to their possible effect on individual properties unless detailed geologic reports are made available.

FOR A LIMITED APPRAISAL

15. That, at the request of the client, the scope of this appraisal report has been limited to include the valuation of only the land and/or improvements that the appraiser considers to have been affected by the proposed taking and construction.
16. That, at the request of the client, the valuation herein reported relates to only a fractional interest in the real estate involved, and that the value of all other fractional interests may or may not equal the value of the entire fee simple estate considered as a whole. The fractional interest appraised relates to only the leasehold estate.

FOR IMPROVED PROPERTY

17. That the appraiser has personally inspected the subject property and finds no obvious evidence of structural deficiencies except as stated in this report; however, no responsibility for hidden defects or conformity to specific governmental requirements, such as fire, building and safety, earthquake, or occupancy codes, can be assumed without provision of specific professional or governmental inspections.
18. That, although no termite inspection report was available, the appraiser personally inspected the subject property and found no significant evidence of termite damage or infestation.
19. That no consideration has been given in this appraisal to personal property located on the premises, or to the cost of moving or relocating such personal property; only the real property has been considered.
20. That consideration has been given in this appraisal to certain items of equipment located on the property and itemized herein, which, in the opinion of legal counsel, are to be considered in the property valuation.
21. That rental areas herein discussed have been calculated in accord with standards developed by the American Standards Association as included in *Real Estate Appraisal Terminology*.
22. That income and expense data herein relied upon were provided by Realty Management Corporation but do not represent an audited return.

FOR PROPOSED CONSTRUCTION

23. That the plans and specifications furnished by the client and prepared by Franklin Jones, AIA, March 10, 1979, upon which this valuation is predicated, are assumed to show the intent of the builder, but the appraiser assumes no responsibility for their correctness or for undisclosed modifications. A copy of the plans and specifications is in the appraisal files.

continued

FOR AGRICULTURAL PROPERTY

24. That no consideration has been given in the appraisal to the value, if any, attributable to growing crops on any portion of the property appraised.
25. That the present owner will be allowed to harvest the current crop.

FOR PARTIAL TAKING

26. That this project will be constructed in the manner proposed as described briefly in this report and in detail in the condemnor's construction plans.
27. That during the proposed construction, existing access and utilities will remain usable by properties presently dependent upon them, or these will be rerouted without disruption in service during the proposed construction, after which they will be replaced to provide usage equal to or better than previously existed.

FOR PIPELINE CONSTRUCTION UNDER AN EASEMENT

28. That the top of the proposed pipeline will have sufficient cover to permit any legal use not specifically prohibited by the wording of the acquisition easement deeds. Copies of these deeds are included in this report.
29. That topsoil replaced after construction will be equal to or better than displaced topsoil.
30. That the excess subsoil will be removed from each parcel where it would adversely affect the parcel after construction.
31. That the construction area of all parcels will be cleared of debris after construction.
32. That the trench area of parcels not under agricultural use will be mounded to accommodate expected settlement after construction.
33. That no consideration is given to potential damage that may or may not arise from ultimate subsidence in the trench area.
34. That construction will be confined to the right-of-way as described in this report.
35. That the condemnor will pay for restoration of all items of permitted use that may be damaged by his entry to and/or over the easement area, regardless of when such items were installed unless such damage occurs from an entry necessary for the removal of items prohibited by the easement language.
36. That where the proposed pipeline crosses watercourses and/or storm water drainage ways, it shall be constructed at a sufficient depth and with sufficient erosion control so as not to interfere with natural water flow or to divert such water flow over adjacent lands.

FOR POSSIBLE UNLAWFUL CONDUCT

37. That the appraiser has become aware, through the media, that certain aspects of the subject property operations are being investigated by the Internal Revenue Service. The value opinion herein reported is based upon reliance on the legality of the subject property operation and resulting financial statements. However, the appraiser reserves the right to consider and evaluate data that become available as a result of the IRS investigation and to make any required adjustment to the value opinion.

FOR REVIEW WITHOUT INSPECTION

38. That the appraiser's sole role in this appraisal was that of review and approval and did not include personal inspection of the property appraised or the market data used.

Scope of Investigation

Some appraisers add a section in the introduction that details the scope of investigation undertaken. This may be presented in a generalized form or in detail. If included, it can be either a narrative or an outline. See Example 7.5.

EXAMPLE 7.5. Scope of Investigation

As part of this appraisal, the appraiser made a number of independent investigations and analyses. She relied on data retained in her office, which is updated regularly for use in all assignments. Listed below are the investigations undertaken and the major data sources.

AREA AND NEIGHBORHOOD ANALYSIS

Examined South Quincy Regional Planning Report for demographic data, land use policies and trends, growth forecasts, and employment data. Reviewed 1979 Planning Update and interviewed Ralph G. Calvin, assistant planning director, in 1980, to ascertain development patterns and trends for portion of Quincy lying west of Interstate 13. Interviewed the following industrial brokers active in the area: Margaret L. Raines of Industrial Realtors, Frank P. Major of Northlake Realtors, and Samuel P. Smith of Morris Industrial Brokers.

SITE DESCRIPTION AND ANALYSIS

Consulted Quincy Planning and Engineering Departments, Public Utility Company, and Suffex County Geologists Office. Reviewed American Title Report 40-31245 prepared January 5, 1980. Physically inspected site on October 1, 1980, walked perimeter of property, and photographed subject site, surrounding area, and street scenes.

IMPROVEMENT DESCRIPTION AND ANALYSIS

Reviewed plans and specifications prepared by Wilson and Wilson, AIA, and inspected similar building at 3150 Crosstown Lane by same architect and builder. Interviewed Judith G. Wilson on October 6, 1980.

MARKET DATA PROGRAM

Vacant and improved transfers were obtained by researching all transfers occurring between January 1, 1979, and October 15, 1980, which were industrially zoned and located west of Interstate 13 and within the Quincy Metropolitan Area. Copies of deeds and financing instruments were obtained from the courthouse and an attempt was made to contact buyers, sellers, or both to verify transaction data and ensure that the sales were at arms length. Details of the verified sales are included in the addenda as Exhibit E.

RENTAL DATA PROGRAM

The brokers listed in "Area and Neighborhood Analysis" above were questioned on the most recent industrial leases consummated in the subject's vicinity. They also provided data on expenses from three similar properties. The appraiser used recent lease data on other properties on file. Morris Industrial Realtors has maintained an industrial property inventory for the past four years, which was consulted for vacancy information.

EXHIBIT 3

GUIDE NOTE 1
To the Standards of Professional Practice

VALUATION OF REAL ESTATE INTERESTS INTENDED FOR SYNDICATION
AND
VALUATION OF REAL ESTATE PARTNERSHIP INTERESTS

GUIDE NOTE 1
To The Standards of Professional Practice

VALUATION OF REAL ESTATE INTERESTS INTENDED FOR SYNDICATION
AND
VALUATION OF REAL ESTATE PARTNERSHIP INTERESTS

Effective May 3, 1985

Introduction

The syndication of real estate has become an important element in the current real estate market. The process of syndication often begins when an individual or group (the syndicator) purchases interests in real estate for the purpose of transferring it to a limited partnership and then selling limited partnership interests to investors. Problems arise for an appraiser when he or she is asked to value the real estate interests at the time of their purchase by the syndicator because the syndicator frequently is buying more than real estate. Problems also arise when the syndicator sells limited partnership interests to investors because of the inherent difficulty involved in separating the value of the interests in real estate from the aggregate value of the limited partnership interests.

In the syndication industry the price of the interests in real estate at the time of acquisition by the syndicator is sometimes referred to as wholesale value; and the aggregate price of the individual partnership interests to be sold by the syndicator is sometimes referred to as aggregate market value, retail value, or syndication value. If these terms are used by an appraiser, however, they must be defined clearly and precisely so that the users of the report and the public will not be confused or misled.

Valuation problems often relate to non-real estate items or conditions involved in the sale and purchase transaction such as special financing and guarantees of occupancy or income. These items are difficult to isolate and evaluate even when all facts are known. In the context of syndication purchases, the problem of analyzing comparable sales is more difficult than usual because it is extremely difficult to obtain all relevant data.

When a syndicator sells the real estate partnership interests to investor purchasers, the sale price of a limited partnership interest includes a variety of items such as tax benefits, management services, and other benefits in addition to the interests in real estate.

The syndication of real estate involves the marketing of highly specialized interests, both real and personal, to a specifically defined group of purchasers with varying motivations. Unless extreme care is taken to distinguish the exact nature of the interests being appraised, valuation conclusions can be greatly distorted or misleading, and an appraiser may become liable to third parties under security and tax regulations that have often been described as punitive.

Basis for Proper Valuation

1. Acquisition by the Syndicator

All appropriate approaches should be used to estimate value. When analyzing comparable sales in the sales comparison approach, all transactions should be specifically analyzed to determine whether non-real estate items were included in the price. If non-real estate items were included, they should be separately identified and their effect on the sale price should be carefully considered.

A limited assignment should be accepted only in unusual circumstances.

2. Sale of Partnership Interests by the Syndicator

Syndicators frequently assert that the aggregate price they are paid by investors who purchase partnership interests establishes the market value of the interests in real estate that are the subject of the syndication. The market value of the interests in real estate is an important item in a syndication because the value of the improvements is used to establish the basis for depreciation which in turn creates substantial tax benefits. The appraiser, however, must carefully analyze the aggregate sale price of the partnership interests sold to investors and separate the value of the interests in real estate from the contributory value of the non-real estate interests sold. Rarely would the retail price of the individual partnership interests sold to investors equal the market value of the interests in real estate. It is essential that the appraiser understand that the partnership interests sold by the syndicator include many non-realty items such as tax shelter, potential capital appreciation, ability to invest in a major property that an investor might be incapable of investing in alone, and management services for the investment.

When valuing fractional interests in a real estate partnership, an appraiser must be certain that all market data is comparable and be acutely aware of what was included in each investment package utilized in the valuation process. In this connection an appraiser can appraise the partnership interest involved either by breaking it down into separate components or by considering it as a whole with all the components properly identified.

Unacceptable Practices

1. Failing to determine whether non-realty items were included in the price of comparable sales.
2. Using the retail price of the aggregate fractional interests in the partnership or the aggregate market value of the partnership as the market value of the real estate interests being appraised.
3. Combining the value of non-real estate items with the value of the real estate interests being appraised without proper identification and analysis.
4. Failing to describe and measure the effects of submarket or atypical financing on the value of the real estate interests being appraised.

EXHIBIT 4

APPRAISAL POLICIES AND PRACTICES OF INSURED
INSTITUTIONS AND SERVICE CORPORATIONS (R 41b)

an estimate of identifiable market demand and sales pace, cites data on competing projects showing size of project, sale price per model and per square foot and sales rates in each development, recaps the anticipated cost of development, and assesses probability of obtaining governmental approval of the proposed development.

(11) *Comprehensive Cash Flow Projection*

The file should contain a cash flow projection which contains data on the following matters projected over the life of the project at quarter-year intervals: sales; expenditures broken down as to land, overhead, development, taxes and interest, marketing, and maintenance; and a calculation of the internal rate of return or profitability analysis.

(12) *Accounting and Other Internal Controls*

The file should contain a description of the type and periodicity of accounting reports to be furnished to the management and directorate of both the service corporation and its parent association(s) together with a description of the controls to be maintained with respect to cash receipts and expenditures in the project. (3/2/77)

R 39 INSURANCE REGULATION 563.33

Paragraph (b) of Insurance Regulation 563.33 provides that any insured institution which agrees in writing with the Corporation to comply with all of the guidelines set forth in paragraph (a) of the section need no longer comply with any present condition of insurance or provision of its agreement for operating policies concerning the composition of its board of directors or the employment of its officers.

Institutions wishing to enter into such an agreement should submit a resolution of their board of directors to the Supervisory Agent. Such resolution should set forth the institution's agreement to comply with Section 563.33(a) recommended guidelines for composition of the board of directors of an insured institution. In the event the existing board of the insured institution is not in compliance with the guidelines, the resolution should include a proposed schedule for bringing the noncomforming directorate into compliance. Such proposed schedule should be for a short a period of time as is reasonably possible consistent with the remaining terms of the existing directorate, but in no event later than the third annual meeting following the date of submission to the Supervisory Agent.

Unless notified by the Supervisory Agent within 30 days after submission of its resolution that the agreement is not acceptable, an institution need no longer comply with any present condition of insurance or provision of its agreement for operating policies concerning the composition of its board of directors or the employment of its officers. (3/2/77)

R 40 [Rescinded]

R 41 [Rescinded]

R 41a [Rescinded]

R 41b APPRAISAL POLICIES AND PRACTICES OF INSURED INSTITUTIONS AND SERVICE CORPORATIONS

(Editor's Note: In addition to consolidating the provisions of Memoranda R 41a and R41a-1 into a single document and incorporating the content of T 15-1, the following significant revisions have been incorporated in the section entitled "Appraisal Procedures":

Item #4—expands and clarifies requirement that appraisals of development type properties reflect deductions and discounts by eliminating the 12 month sell-out/occupancy threshold formerly provided by R-41a.

Item #5—expands and clarifies expected use of market/economic feasibility assessments to include support of appraiser's conclusion of highest and best use as well as of probable success of the project.

Item #7—revises definition of "Market Value" to reflect terminology currently in use by leading professional appraisal organizations and, consistent with the collateral lending posture of the savings and loan industry, the need to obtain the most probable selling price should the property be placed on the market under the conditions herein specified.)

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 the appraisals of the real estate. This memorandum provides guidelines for appraisal management and procedures to assist in determining compliance with the appraisal requirements of Insurance Regulation 563.17-1(c)(1)(iii).

Appraisal Management

The lending policies established by the board of directors will determine the complexity and diversity of appraisal situations to be encountered and, therefore, the general requirements of the association or service corporation for appraisal staff and facilities. Management should ensure that appraisal services provided, whether by fee or staff appraisers, meet the current needs of the association or service corporation.

An appraisal should serve an underwriter's needs by providing a supported opinion of a property's market value as of a specified date sufficiently current so as to reduce the likelihood of material value fluctuations prior to the loan/investment decision. In addition to providing estimated market value, the appraisal should give the appraiser's opinion of the property's feasibility and marketability. An accurate and useful appraisal is most often produced by a

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Source: Federal Home Loan Bank of Chicago

capable and suitably equipped fee or staff appraiser who has ready access to current market information. Therefore, each association and service corporation should be able to demonstrate that its fee and staff appraisers are competent and knowledgeable of the relevant markets, and have the facilities necessary to perform adequate appraisals.

Appraisal skills and professional requirements are not static. Staff appraisers should continually increase their knowledge and skills through attendance at courses sponsored by universities, colleges, and/or professional organizations. Memberships in professional appraisal organizations should be encouraged. Attendance at courses and participation in the activities of professional organizations are also useful factors for management to consider in selecting independent fee appraisers.

Appraisal Procedures

The appraisal content shall follow generally accepted and established appraisal practices, as reflected in the standards of the nationally recognized professional appraisal organizations.

Specifically, each appraisal report must:

1. be totally self-contained so that:
 - a. it is a useful tool for prudent underwriting, REO and/or LTF decisions.
 - b. 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.
 - c. it demonstrates professional competence, ethics and expertise.
2. be of a narrative style for major loans and/or investments made by the association or affiliates.
3. contain all recognized approaches to market value unless the appraiser fully explains and documents the rationale for eliminating one or more of the approaches to value.
4. take into consideration and make provision for all appropriate deductions and discounts for any development type property.
5. address itself to the market/economic feasibility prospects for any proposed major loan/investment real estate project, in sufficient detail to support the appraiser's forecast of the probable success and the conclusion(s) of highest and best use. If a market/economic feasibility report is prepared by other than the appraiser, the appraiser will set forth the reasoning and rationale for accepting or rejecting said report. All such market/economic feasibility studies will be made a permanent part of the appraisal report.
6. contain, if for major loan/investment properties (except for home type properties) located in highly speculative local market areas which have experienced dramatic price increases relative to regional norms, a sales history analysis

of the subject property covering the speculative time period. This analysis should reasonably disclose and verify:

- a. grantor(s)-grantee(s).
 - b. sale date(s).
 - c. sale price(s) and terms of financing, discounting the sale to a cash equivalent, where necessary.
 - d. any interrelated parties to each transaction.
7. address itself to "Market Value", as hereby defined and qualified:

The most probable price in terms of money which a property should bring in 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 they consider their own best interest.
- c. a reasonable time is allowed for exposure in the open market.
- d. payment is made in cash or its equivalent.
- e. financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale.
- f. the price represents a normal consideration for the property sold unaffected by special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction.

Market value as defined is applicable in all lending/investment circumstances for insured associations and affiliates, including special purpose properties and REO/LTF situations. In REO/LTF situations, defined market value estimates will be derived on an "as is" basis. Under no circumstances should the appraiser further qualify or, by assumptions, erode the impact of this definition. All market data inputs should be thoroughly analyzed and, where necessary, adjusted in terms of the above definition, as qualified.

As reflected in qualifications d, e and f of the above definition, all valuations must be couched in terms of "cash or its equivalent" and "typical financing" for that particular property type.

Any valuations which by assumption or qualification effectively utilize any form of specialized, unique and/or subsidized financing assumptions as surrogates for "typical financing" assumptions in the appraisal methodology are not considered to be acceptable. All properties, regardless of the specific nature of the particular financing arrangements then

existing and/or as proposed, must be evaluated in a market value context as defined and as qualified relative to "typical financing" and "cash equivalency."

For certain governmental subsidy programs, such as HUD Section 8 Programs, where the real estate project and the ultimate product user represent a distinct and readily identifiable separate market relative to those projects found in the typical market, the appraiser may consider the various subsidized income/vacancy guarantees and/or subsidized aspects of the specific financing/contractual programs. In no case, however, should the final value estimate exceed replacement cost. Replacement cost in this context refers to the sum of the following:

1. market value of the subject site ("value" conforming to the above referenced market value definition).
2. current reproduction cost less deterioration and obsolescence of all building and site improvements.
3. a reasonable, market-supportable, entrepreneurial profit.

Please note that the definition of "market value" contained in this memorandum supersedes all older definitions of "market value" or "fair market value" previously deemed acceptable to the Bank Board. Memorandum #T 13-1, which contains a now obsolete definition, is hereby rescinded. It should be understood, however, that the long-standing examining and supervisory policy described in #T 13-1 remains in effect. Substantial variations between the appraised "market value" of a property and its actual selling price (and/or book value in the case of REO) will continue to be carefully scrutinized during the examination process. (3/12/82)

R 42 REASONABLENESS OF COMPENSATION AND FEES

The Board of Directors of an insured institution or affiliated service corporation has the responsibility for the determination of compensation of officers of the institution which, in accordance with Insurance Regulation 563.17(b), must be reasonable and commensurate with their duties and responsibilities.

Such compensation generally includes: remuneration such as salary, bonus, profit sharing, and fees for serving as a director, advisory director, or member of an executive, loan or other committee; as well as annuities, options, pension or other retirement benefits.

In making the determination concerning institution officers, the Board of Directors should include at least the following in the factors to which consideration is given:

1. The qualifications and experiences of the person(s) concerned;

2. The compensation paid to other persons employed by the institution or service corporation;
3. The compensation paid to persons having similar duties and responsibilities in other insured institutions or service corporation affiliates;
4. The size of the institution or service corporation, and the complexity of its operations;
5. The financial condition, including income, of the institution or service corporation and the individual's contribution thereto;
6. Any amounts received, either directly or indirectly, by the officer whose principal occupation is with the institution or service corporation for other services performed for the institution or service corporation (i.e., fees for serving as appraiser, attorney, escrow agent, insurance agent, etc.);
7. The value of personal fringe benefits provided to the employee and also perquisites such as an automobile, club membership and expense account.

With respect to fees of outside appraisers or attorneys, the Board of Directors is responsible for a determination of whether those fees are reasonable and commensurate with the services being performed. The responsibility will not necessarily be satisfied by a determination that the fees (particularly if the outsider appraiser or attorney is an affiliated person) are comparable to those charged by other appraisers or attorneys performing similar services for other insured institutions in the same area. In exercising its responsibility, the Board should also consider the comparative advantages to be gained by the institution or service corporation by employing a staff appraiser or attorney to perform its appraisal and legal services.

In establishing fees to be paid to members of the board, each director should be keenly aware of his fiduciary responsibilities. Each should keep in mind that one of his primary responsibilities is to establish policies which will protect the assets of the association. Thus, directors should use similar factors in setting such fees as it does in setting officer's salaries. The minutes of the Board of Directors should include the record of deliberations concerning salaries for officers and fees for attorneys, appraisers and directors, and the records of the board should support the conclusions reached. (8/2/77)

R 43 CREDIT CARDS

The staff of the Bank Board has concluded that, under certain circumstances, Federal associations presently have the authority to issue credit cards. That conclusion is confirmed in a letter directed to California Federal Savings and Loan Association, a copy of which is attached to this memorandum. In arriving at that conclusion, the staff also recognized

EXHIBIT 5

GUIDANCE NOTES WITH BACKGROUND PAPERS
ON
THE VALUATION OF FIXED ASSETS

Documents in Exhibit 5 deleted; ownership unclear
and request for permission from International Asset Valuation
Standards Committee not returned

EXHIBIT 6

RICS Guidance Notes on the Valuation of Assets - 2nd Edition

Guidance Note No. GN 22

**LAND AND BUILDINGS
DEFINITIONS OF 'OPEN MARKET VALUE' AND
'FORCED SALE VALUE'**

Guidance Note No. GN 22

**LAND AND BUILDINGS
DEFINITIONS OF 'OPEN MARKET VALUE' AND
'FORCED SALE VALUE'****1. Open Market Value**

1.1 'Open Market Value' is intended to mean the best price at which an interest in a property might reasonably be expected to be sold by Private Treaty at the date of valuation assuming:

- (a) a willing seller;
- (b) a reasonable period within which to negotiate the sale taking into account the nature of the property and the state of the market;
- (c) values will remain static throughout the period;
- (b) the property will be freely exposed to the market;
- (e) no account is to be taken of an additional bid by a special purchaser.

1.2 The Institution stresses that if a valuer considers it appropriate to apply any qualifying words to 'Open Market Value', the meaning of those words should be discussed and agreed with the client before instructions are finally accepted. The Valuer should incorporate in his report the agreed meaning of the qualifying words.

1.3 It is emphasised that this definition can in no way override any statutory definition of market value which may have to be adopted for the purpose of valuations for Capital Gains Tax, compensation cases, etc.

2. Forced Sale Value

2.1 'Forced Sale Value' is the Open Market Value as defined above with the proviso that the vendor has imposed a time limit for completion which cannot be regarded as a 'reasonable period' as referred to in Para. 1.1.

2.2 If the term 'Forced Sale Value' is used members are advised that the time limit should be discussed and agreed with the client.

THE VALUATION OF PLANT AND MACHINERY ASSETS

1. General

1.1 The Companies Act 1967 requires that assets shall be classified in the balance sheet under headings appropriate to the company's business and further that fixed assets, current assets and assets that are neither fixed nor current be separately identified but the Act contains no definitions of these classes of assets, although it refers to investments, goodwill, patents and trademarks in terms which recognise the possibility that such assets may be so classified. It should be noted that the very word 'fixed' is somewhat of a misnomer; ships, motor vehicles, railway engines and heavy movable equipment including cranes will be included although some may be classified as 'neither fixed nor current'. Smaller items of plant and machinery, particularly where they are movable, are often classified, for accounting purposes, as neither fixed nor current.

1.2 As a matter of practicality, many companies use a minimum expenditure level to account for capital expenditure; thus any item costing less than a specified amount is written off to revenue in the year of purchase whereas strictly speaking such expenditure could be charged to a fixed asset account.

1.3 Current assets (which will include stocks and work in progress) are in general those assets which are expected to be consumed or realised in the ordinary course of business in the short term.

1.4 The precise nature of the asset is not the only criterion as regards classification. Assets considered to be 'fixed' in one business would not necessarily be so in another.

1.5 When Valuers are asked to make a valuation whether it be of land and buildings or plant and machinery for inclusion in a company's accounts (whether by incorporating the valuation in the accounts or by a reference in a note or in the directors' report) it is essential that there should be a clear understanding by all concerned of what is being valued and the date of the valuation. Valuation Reports and Certificates should clearly define inclusions and exclusions. It is also essential that there should be a clear understanding of the basis of valuation and the proposed treatment of that valuation in the accounts, etc., in order to ensure that there is a proper comparison between the valuation and the book amount of the same assets. Unless this understanding exists between the directors, the accountants and the valuers concerned, there is always the risk that misleading comparisons will be drawn.

2. Basis of Valuation

2.1 Basic accounting concepts postulate that accounts are on a going concern basis, that is to say that the enterprise will continue in operational existence for the foreseeable future. The normal basis of valuation of plant and machinery where the valuation is to be incorporated or referred to in the accounts, etc., of a company should therefore be its open market value on the assumption that the plant and machinery will continue in its present existing use in the business of the company. Normally this existing use basis of valuation will be depreciated replacement cost, i.e., the estimated cost as new at the date of the valuation including the cost of installation less an allowance for depreciation (i.e., wear and tear, age and obsolescence). Account should be taken in the valuation, however, of special factors such as scarcity value or the possible limitation of value caused by limited natural resources or the building housing the plant having a limited life or being held on a limited tenure or with limited planning consent. Further it is necessary to consider both individual and overall values of the plant.

See GN 11

2.2 In some cases an existing use basis of valuation will not be appropriate. It would almost certainly be inappropriate to use an existing use basis of valuation of plant and machinery where the plant and machinery are valued on an alternative basis.

See GN 1 and BP 2

the effect on the value of plant and machinery. In these circumstances the following alternatives would be available:

- (a) where the plant and machinery could be moved to and used by the company at another site, the valuation would be on a depreciated replacement cost basis, but making an allowance for the costs of removal and reinstallation;
- (b) where plant and machinery is to be disposed of rather than used in the company's business it would then be valued on an open market value basis. If there is a time limit on the disposal, forced sale value may be the proper basis of valuation.

2.3 Where the land and buildings have not been valued, then the plant and machinery should be valued on the basis that would have been appropriate had the land and buildings been valued.

See GN 24

2.4 Definitions of open market value and forced sale value are given in GN. 24. These definitions are to be used for the purpose of valuations which are to be used in company accounts, etc., and they cannot override any statutory definitions of market value which may have to be adopted for the purpose of valuation for capital gains tax, compensation cases, etc.

2.5 In all instances, it is essential that, in advance of the valuation being carried out, there should be a clear understanding with the company and its accountants (and probably its auditors) of what is to be valued, the reasons for the valuation, the use to be made of the valuation and all the surrounding circumstances so that the appropriate basis can be determined.

3. Plant and Machinery forming part of a Building

3.1 Problems have arisen when valuing land and buildings where there are items of plant and machinery which are regarded by the valuer as forming part of the building but which the accountant may wish to segregate for accounting purposes. Valuers when valuing premises will normally include all items of plant and machinery on the premises which provide the services to the land and buildings and which the open market regards as an integral part of the premises for letting or sale or as security for a loan.

See GN 25

3.2 A list of such items is given in GN 25 but it is stressed that the list is not comprehensive and merely indicates, as a general guide to valuers, those items that would usually fall to be included in the value of the premises.

3.3 Normally process plant and machinery should not be included in the valuation of the premises.

3.4 It is possible that some or all of these types of plant and machinery normally included in the valuation of the premises may be needed to be separated for accounting purposes, for instance when it is expected that they have a shorter useful life than the rest of the premises and depreciation is being provided accordingly.

3.5 An apportionment of a valuation as between:

- (i) land and buildings; and
- (ii) the plant and machinery element;

may also be necessary in order to correspond with the headings adopted by the company in its accounts.

3.6 In such circumstances Valuers will have to indicate clearly that their valuation is of the whole and that any apportionment is an allocation of their overall valuation between the different components. This should also be stated in the notes to the Company Accounts if the apportioned figures are referred to therein.

4. Dies, Moulds, Patterns and Spare Parts

4.1 As a general rule, dies, moulds, patterns, jigs, drawings, designs and similar items should be excluded from a valuation.

4.2 In the normal course of events, spare parts would not be valued as part of the unit as it is often the practice for these to be carried in stock, and only auxiliary items necessary

4.3 In both cases, Valuers should consult with the directors and auditors in order to take the appropriate action.

5. Plant and Machinery Register

5.1 It is recommended that all companies be encouraged to maintain an up-to-date plant and machinery register showing as a minimum, the location of each item of plant and machinery, its date of acquisition, original cost and any further capital expenditure as this assists considerably in a valuation and its reconciliation with the company accounts.

6. General

6.1 Valuers are advised to discuss with the Company Accountants and Auditors the requirements of the valuation before carrying out the detailed valuation.

6.2 Reports and Certificates should incorporate suitable savings clauses covering the treatment in the valuation of such items as assets on hire purchase, government grants and goodwill.

7. Consent

7.1 The Valuer's Certificate should state that his written consent to any reference to his valuation in company accounts and/or directors' reports or any company statement or circular must be obtained before such documents are published. All Valuation Certificates should, therefore, incorporate a paragraph to the effect that:

'Neither the whole nor any part of this Valuation Certificate or any reference thereto may be included in any published document, circular or statement nor published in any way without the Valuer's written approval of the form and context in which it may appear.'

**PLANT AND MACHINERY
DEFINITIONS OF 'OPEN MARKET VALUE' AND
'FORCED SALE VALUE'**

1. Open Market Value

1.1 'Open Market Value' is defined as the best price at which an interest in the plant and machinery might reasonably be expected to be sold at the date of valuation by either Private Treaty, Public Auction or Tender, as may be appropriate assuming:

- (a) a willing seller;
- (b) a reasonable period within which to negotiate the sale, taking into account the nature of the plant and machinery and the state of the market;
- (c) values will remain static throughout the period;
- (d) the plant and machinery will be freely exposed to the market;
- (e) no account is to be taken of an additional bid by a special purchaser;
- (f) the plant and machinery may be valued, either
 - (i) as a whole in its working place, or
 - (ii) as individual items for removal.

2. Forced Sale Value

2.1 'Forced Sale Value' is defined as the open market value as defined above with the proviso that the vendor has imposed a time limit for completion which cannot be regarded as a reasonable period as referred to in above.

2.2 If the term 'Forced Sale Value' is used members are advised that the time limit should be discussed and agreed with the client.

**PLANT AND MACHINERY
ITEMS OF PLANT AND MACHINERY NORMALLY INCLUDED
IN VALUATIONS OF LAND AND BUILDINGS**

1. The following observations are intended to apply in the valuation of assets comprised in the majority of industrial and commercial types of property. Factory premises of a specialised nature will often require individual treatment and segregation to meet particular circumstances. In the case of sale, fire insurance, rating, etc., different criteria may apply. The list which follows, however, whilst not comprehensive, indicates those items usually valued on the basis that they form part of the 'building' service installations as opposed to those provided as part of the industrial or commercial processes carried on by the occupier. It follows that the valuation of land and buildings would normally exclude all items of plant, machinery and equipment which may have been installed wholly or primarily in connection with the occupiers' industrial or commercial processes, furniture and furnishings, tenants' fixtures and fittings, vehicles, stock, moulds and loose tools. The excluded items may need to be separately valued for balance sheet or other purposes.

2. **Electricity**

Mains supply cables, transformer houses with transformers, sub-stations and their equipment, generating plant and associated equipment including standby plant, and all wiring and switchgear up to and including the main distribution board in each building, together with:-

(a) *In non-industrial buildings:*

Wiring for lighting and power from the distribution board to wall and ceiling points.

(b) *In industrial buildings:*

Wiring for lighting to wall and ceiling points.

Note: (power circuits from the distribution board would normally be excluded on the grounds that these are related to the processes).

(c) *Externally:*

Wiring and associated structures for lighting to roads and yards, etc.

3. **Gas**

Gas mains up to and including meter houses and piping from meter houses for non-process purposes. Where the property includes a gas producer plant this would normally be in connection with the occupier's industrial processes and would, therefore, be excluded.

4. **Water**

Wells, boreholes, pumps, pump houses, service pipes including those connected to Water Board's mains, water treatment plants, storage tanks and reservoirs and all structures required to contain, support or house such items.

5. **Space Heating and Hot Water**

5.1 Boilers and associated plant including fuel tanks, pipes and fittings (e.g., radiators and unit fan heaters) primarily supplying or using steam or hot water for space heating and other non-process purposes.

6. Air Conditioning and Ventilation

Air conditioning plant and trunking and fan extractors and ventilators except where forming part of a computer installation or primarily serving plant and machinery used in industrial or commercial processes.

7. Fire and Security

Hydrants, pumps and mains, sprinkler systems, smoke detectors and annexed fire and burglar alarm systems.

8. Drainage

8.1 Surface water and foul water drains and sewers.

8.2 Sewage disposal plants not primarily concerned with treating water and other liquids used in the processes of trade effluents.

9. Lifts and Gantries

9.1 Passenger and goods lifts, escalators and travelators designed to benefit the general occupation of a building.

9.2 Rails and supporting gantries for overhead travelling cranes where forming an integral part of the structure of a building.

Note:

Hoists, conveyors, elevators, overhead cranes, jib and derrick cranes would normally be excluded.

10. Structures

10.1 The decision upon which items should be included will, to some extent, depend upon general experience and the practice adopted by individual trades.

10.2 Among the criteria will be the degree of attachment, permanence and size. Structures which are necessary for the provision of the services or have been installed or erected other than for the industrial or commercial processes carried out on the property would normally be included in the valuation of land and buildings. Such items might include the following:

- Boiler houses, Chimneys (brick and steel) and Economiser Chambers;
- Pits;
- Stagings;
- Internal Buildings;
- Permanent Partitions;
- Railways;
- Bridges and Housings for Conveyors;
- Fences;
- Roads, Yards and Hard Standings.

10.3 Structures which are ancillary to, or form a part of an item of Process Plant and Machinery, would normally be excluded.

EXHIBIT 7

RICS Guidance Notes on the Valuation of Assets - 2nd Edition

Guidance Note No. GN 26

THE VALUATION OF PENSION FUND PROPERTY ASSETS

THE VALUATION OF PENSION FUND PROPERTY ASSETS

1. INTRODUCTION

1.1 The RICS draws the attention of members to the following guidance which should be observed when instructed to value the property assets owned by Pension and Superannuation Funds. This Note refers to a number of matters which should assist members but the general recommendations set out in the Guidance Notes Handbook should continue to be observed. It is recommended that the valuer should have discussions with the Trustees or the Fund Manager in order to establish the precise nature of the work required and to acquaint himself with the Fund's valuation policy and rules.

1.2 This Note applies equally to internal, external and independent valuers although, as indicated below, there can exist in certain specified circumstances special requirements which should be observed.

1.3 Funds may hold investments in companies, trusts or other entities, which in turn may own property assets. If valuers are instructed to provide a valuation of those property assets they should be valued and reported to the particular entity as separate valuations.

1.4 The term 'Trustees' includes any body of persons who have the ultimate responsibility for the investments and operation of the Fund.

1.5 The term 'Employer' refers to the body with whom the member of the fund has a contract of employment.

1.6 The term 'Fund Manager' refers to the individual to whom the Trustees may have delegated investment powers.

2. CATEGORIES OF PROPERTY

2.1 Properties owned by Funds should be categorised into four groups:—

- (a) Properties held as investments
- (b) Properties in course of development
- (c) Properties held for development
- (d) Properties in owner occupation.

2.2 Properties held as investments are those on which construction work has been completed and which are owned for the purpose of letting to produce a rental income which is negotiated at arm's length with third parties.

2.3 Properties in course of development include properties which have been acquired with vacant possession with the intention of seeking an early arm's length letting to a third party with or without works of repair or improvement being required. Apart from properties where work is in actual progress there should be included in this category any property where a start is imminent because all appropriate consents have been obtained and a building contract has been exchanged.

2.4 Properties held for development are those acquired with the intention to redevelop at some future date, with or without further properties not yet acquired, and which also do not fall within the other three categories.

2.5 Properties in owner occupation include any property which is subject to any form of intercompany leasing or licensing arrangement between the Fund and a subsidiary. Such arrangements should, therefore, be ignored. Properties which are partly occupied by the owner should only be included in this category if the occupation is substantial, say one-

3. BASIS OF VALUATION

3.1 The bases of valuation which should be adopted for each property category are:—

(a) Properties held as investments

Open Market Value.

(b) Properties in course of development

Cost, but if there is a permanent diminution in value to below cost, then at open market value, assuming the development is complete with the benefit of any contracted lettings less the estimated cost to complete. Properties should be valued on this basis until the earlier of either being fully let or a period, as may be appropriate, not exceeding twelve months from the date of practical completion.

(c) Properties held for development

Open Market Value.

(d) Properties in owner occupation

(i) Non-specialised properties—Open market value for existing use assuming vacant possession.

See GN11 and BP3

(ii) Specialised properties (See Guidance Note No. GN 11 and Background paper No. BP 3)—Depreciated replacement cost subject to adequate potential profitability.

Notes:

The Fund may occupy properties for its own administrative offices or a purpose such as farming or forestry either in hand or under some form of inter-company leasing or licensing arrangement between the Fund and a subsidiary, under which a business is either directly operated by a third party and/or the Fund.

See BP7

Certain properties like hotels and petrol filling stations are valued as fully operational business units (see Background Paper No. BP 7 on the subject of Open Market Valuations having regard to Trading Potential).

The Valuer should discuss with the Trustees or the Fund Manager whether it would be appropriate to undertake separate valuations of other items of fixed assets or current assets used in connection with the occupation of properties which come within this category.

In appropriate cases the valuer should draw attention to the existence of any material alternative use and the value attributable thereto where significantly different from the figure of open market value for existing use or depreciated replacement cost to be reported.

3.2 The valuer should enquire whether the valuation will be adopted for the purposes of an actuarial valuation and if so whether there are any specific requirements for the property valuation depending on whether the actuary is making a 'continuing' or (going concern) or a 'solvency' (or discontinuance valuation.)

3.3 The Fund should have a stated policy on the treatment of financial carrying charges. In the absence of such a policy if a valuer is requested to ascertain the figure of 'cost' for property in the course of development it would be usual to include a financial carrying charge. If a finance agreement exists with a third party the prescribed rate of interest should be adopted. If the property is a direct development of the Fund or no interest rate is stated in the agreement the valuer should adopt either an opportunity cost rate or a

4. THE VALUER

4.1 Valuers should meet the definition in Guidance Note No. GN 3 and can be internal, external or independent valuers, providing:— See GN3

- (a) If the Trustees should require an *independent valuation* the valuer must be *external* and also be able to comply with the requirement for an independent valuation in Guidance Note No. GN 3. An external valuer should always consider declining to accept instructions to carry out an independent valuation of certain properties if he considers that a conflict of interest could possibly arise. An external valuer who normally acts for the Fund in acquisitions and management would not generally be able to meet the requirements for an *independent valuation*.
- (b) If an internal valuer is not engaged wholtime on duties in connection with the properties of the Fund and also does not have a sole responsibility to the Trustees he may not meet the definition of a qualified internal asset valuer. It is for the internal valuer to satisfy himself as to where lies his responsibility.
- (c) If an external valuer is employed also by the Employer in respect of properties not owned by the Fund he may not meet the definition of an external asset valuer. It is for the external valuer to satisfy himself as to where lies his responsibility.
- (d) An external valuer responsible for the sale of a property to a Fund should not value the property for the Fund for a period of two years after the purchase.

4.2 The Employer and the Trustees should each be independently advised in any case relating to the transfer of any interest in a property between the Employer and the Fund, or in any matter affecting value, such as the disposal by way of sale/letting and rent reviews and where the Employer and the Fund have different legal interests in a property which could give rise to a conflict of interest. It follows that neither an internal nor an external valuer nor any RICS member should, therefore, act in such connection unless in the case of the last the RICS member had been appointed by both the Employer and the Trustees to act as an independent expert or arbitrator between the parties.

4.3 If the Fund wish to appoint an *independent valuer* he should conform to the definition contained in paragraph 3 of Guidance Note GN 19. See GN19

5. THE VALUATION CERTIFICATE

5.1 The Valuation Certificate should conform to Guidance Note GN 5 but in addition the valuer should provide the aggregate totals of the net rental income (after the deduction of all outgoings including ground and head rents but not amortization) passing at the date of valuation and at such other yearly anniversary dates in order to report reversionary increases/decreases based on market values current at the valuation date. The projection would not normally be for a period beyond ten years. See GN5

5.2 In normal circumstances the valuer should report to the Manager of the Fund but internal and external valuers must be prepared, if necessary and appropriate, to take steps to ensure that the Trustees individually have a sight of a copy of the Valuation Certificate but not necessarily copies of the schedules of properties.

5.3 It is emphasised that the Valuation Certificate should always contain a non-publication clause (see Guidance Note GN 5). See GN5

5.4 Internal, external and independent valuers should ensure that the following information is available in the Valuation Certificate to the Trustees:—

- (a) The total value of properties to be divided into:—
 - Freehold
 - Leasehold—long and short.
- (b) Para. (a) to be divided between:—
 - Completed investments
 - In course of development

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- (c) Total gross rents
 less Ground and Head rents
 Property expenses (but not amortization)
 Total net rental income.
- (d) A projection of reversionary increases/decreases at yearly anniversary dates based on market values current at the valuation date, as set out in para. 5.1.
- (e) The percentage of the breakdown by capital value of the portfolio as between offices, retail, industrial, agricultural and others to be stated, differentiating between the U.K. and Overseas properties.
- (f) The date and basis of the valuation and the name and qualification of the valuer(s).

5.5 It is the policy of The Royal Institution of Chartered Surveyors to encourage its members to request that the foregoing information is included in any published Report or Accounts to the extent that it is relevant and material to the valuation of the assets.

6. PLANT AND MACHINERY

See GN23

Any plant and machinery to be included in the valuation should be valued in accordance with Guidance Note GN 23.

7. FREQUENCY OF VALUATIONS

7.1 The Trustees have the responsibility for deciding the frequency at which valuations shall be made and whether by an internal, external or independent valuer. Nevertheless a member, who is engaged on duties which include those of an investment advisor and/or portfolio manager, will need from time to time to make capital and rental valuations. When such valuations are made he should draw to the attention of the Fund Manager or Trustees when appropriate any significant changes in the values of individual properties or in market conditions affecting the whole or part of the portfolio.

7.2 When a valuer is instructed he should recommend, in respect of any property falling within the category 'in course of development', where cost over-runs are a very real risk, that a valuation be made each year until the property is moved into another category in order to satisfy the Trustees that there has been no permanent diminution in value.

8. DISCUSSION PAPER

A discussion paper is being prepared by the Accounting Standards Committee. If this discussion paper is followed by an Accounting Standard it may be necessary to issue an amendment to this Guidance Note.

July 1981

Background Paper No. BP 1

EXISTING USE VALUE

1. Fixed assets which are included in the balance sheet should, in accordance with existing law and accountancy practice, be stated on the basis of cost, or at a valuation (which may or may not be current). When assets are stated at a valuation it is assumed that the business will continue and in many cases the basis to be adopted is open market value for existing use with vacant possession.
2. Open market value for existing use as a basis for valuations to be incorporated into a Company's balance sheet, or for reference to in the notes, takes into account the RICS definition of open market value but with the added assumption that the property will continue as owner-occupied in its existing use, and thus ignores any possible alternative use of the property, any element of hope value, any value attributable to goodwill and any possible increase in value due to special investment or financial transactions such as sale and leaseback which would leave the company with a different interest from the one which is to be valued.
3. Open market value for existing use would, however, include the possibilities of extensions or further buildings on undeveloped land or redevelopment of existing buildings providing such construction can be undertaken without major interruption to the continuing business.
4. It is not unusual for the occupation of business premises to be subject to a planning consent which is personal to the occupier. Bearing in mind that accounts are normally prepared on the assumption that the business is to continue in operation for the foreseeable future, it is recommended that open market value for existing use should disregard any planning problems which may arise in the event of the owner vacating. It is, however, recommended where the occupation is subject to a personal planning consent (unless this limitation applies for a relatively short period only), the valuer should report in addition to open market value for existing use the open market value having regard to the particular planning situation. The latter figure will take account of possible alternative uses to the extent to which these would be reflected in the price obtainable on a sale.
5. Existing use for the valuation of land and buildings in company accounts does not carry the same meaning as in planning law, or as current use for D.L.T. purposes, nor does it necessarily mean the particular trade currently being undertaken on the property. Many buildings are general purpose structures suitable for a wide variety of different trades. Similar industrial buildings will probably have the same values irrespective of the different trades that are carried on, and this would also apply to shops. A factory is valued as a factory, not as a particular type of factory, and a shop as a shop, not as a particular type of shop (unless the market differentiates between the two).
6. There is a separate Background Paper "Adaptation Works and Costs" on the treatment of properties which have been adapted to meet the special requirements of the business in occupation. Likewise there is a further Background Paper "Depreciated Replacement Cost Basis of Valuation" applicable to properties which are of the type that are rarely, if ever, sold in the open market for their existing use except by way of a sale of the business in occupation.
7. There are certain types of property designed or adapted for particular uses, including hotels, public houses, cinemas and clubs. Such properties are normally valued having regard to trading potential and a separate Background Paper deals with this subject.

Background Paper No. BP 2

ALTERNATIVE USE VALUE

1. Land and buildings may possess a value differing from their existing use value when the prospective use of the property for some other purpose is reflected (i.e. 'alternative use value').
2. Normal accounting concepts assume an ongoing business and where properties are occupied for the purpose of the business an alternative use value, which could only be realised on liquidation or a closure or removal of the business to other premises, is not suitable for inclusion in the accounts.
3. Such alternative use value may, however, have relevance to an overall appraisal of the company's situation. Where it differs materially (either above or below) from existing use value it should be reported by the valuer, whether the existing use value is on an open market basis or by reference to depreciated replacement cost. In the case of property occupied by a business under a personal planning consent it is recommended that the valuer should always include in the Valuation Certificate, in addition to open market value for existing use, a reference to open market value without the benefit of the personal consent.
4. It is probable that the alternative use value will be referred to in the notes to the accounts or the Directors' Report if it is above the open market value for existing use.
5. Where land and buildings are declared by the Directors to be surplus to trading requirements, they will be assessed to open market value which takes into account any possible alternative use. Such properties will be shown separately in the Valuation Certificate to enable the company to make a deduction for the estimated expenses of sale to arrive at the recoverable amount.
6. Land and buildings held as investments or for development will also be valued on an open market basis, subject to relevant existing tenancies and this will take into account any alternative use if appropriate.
7. In all cases, alternative use value should be related to definite information as to statutory or other consents (e.g. superior landlord's approval) regarding change of use or other matters, and it would not be appropriate to make unfounded assumptions.
8. It may be noted that in exceptional circumstances, which are more likely to arise on leasehold land, an alternative use value may be negative.

EXHIBIT 8

RICS Guidance Notes on the Valuation of Assets - 2nd Edition

Guidance Note No. GN 19

NOTES FOR INDEPENDENT VALUERS OF
UNIT LINKED PROPERTY ASSETS OF LIFE INSURANCE COMPANIES

NOTES FOR INDEPENDENT VALUERS OF UNIT LINKED PROPERTY ASSETS OF LIFE INSURANCE COMPANIES

1. This Guidance Note is of particular interest to those concerned with the valuation of Property Funds of Life Insurance Companies and it is recommended that the principles and procedures set out should be generally followed unless the Valuer considers that there are special circumstances existing, which justify a deviation. Other Guidance Notes incorporate those principles which would normally be followed in making valuations but it is considered that there is a practical value in bringing them together with certain specifics applying to the valuation of properties within a Property Fund.

2. Introductory

2.1 It is stressed that the Fund Managers are solely responsible for the investment policy of the Property Fund, the selection of properties, the pricing of units and the management of the Fund and the independent Valuer plays no part in these functions.

2.2 The Valuer should arrange his appointment on terms which allow him to require the Fund Managers and others to give him the fullest co-operation.

3. Independence of Valuer

3.1 It is normal practice for firms and not individuals to be appointed as Independent Valuer to a Property Fund and this is felt to be in the best interests of all concerned as it is both practical and adds strength to the standing of the Valuer's appointment.

3.2 In accepting an appointment as an Independent Valuer to a Property Fund the firm or the individual should apply terms which ensure that they can be seen to act in an independent role free from any suggestion that their judgement might be influenced by other relationships with the Fund Managers or promoters.

3.3 To accord with this independent role the firm should follow these principles:

- (a) they should not be employed by the Property Fund in any other capacity;
- (b) they should neither act for the Property Fund in purchasing any property nor act for the Property Fund or a purchaser in the sale of any property owned by the Property Fund;
- (c) if they act for the vendor of a property bought by the Property Fund then another Valuer should value that property after its acquisition, but at the expiry of two years thereafter the Independent Valuer to the Property Fund should value the property;
- (d) they should have no direct financial interest in the management of the Property Fund or its promoters. This should not be regarded as a barrier to the Valuer holding a very minor interest, providing it could not influence or be affected by the Valuer's judgement.

4. Terms of Appointment

4.1 The appointment should be in writing and made by the Trustees or Fund Managers. The Valuer should satisfy himself that he will be free to follow, as appropriate, the contents of this and other Guidance Notes.

4.2 The Trustees or Fund Managers will have the right to call on the Valuer at any time to value the whole or any part of the portfolio and the Valuer should have a reciprocal right.

4.3 If the Valuer's appointment is terminated he should possess the right not only to value the whole or any part of the portfolio but to have his Valuation Certificate issued to the auditors and Unit holders. If the Valuer chooses to resign he should possess a

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4.4 Normally there should be only one Valuer to a Fund except when Para. 3.3(c) applies or when the portfolio includes:

- (a) overseas properties in areas where the Independent Valuer feels unable to value;
- (b) specialist properties outside the qualification and experience of the independent valuer, e.g. agricultural land.

4.5 The Valuer should have the right of direct access to the Fund's auditors.

5. Basis of Valuation

See GN 22 and BP 2

5.1 The basis of valuation should normally be open market value (thus reflecting any element recognised in the market generally for an alternative use) and the date of the valuation clearly stated.

5.2 Any assumptions made by the Valuer must be clearly set out and any qualifications to 'open market value' stated and their meaning explained.

5.3 Valuers should not include forward projections of value in their Valuation Certificates.

5.4 Valuers will normally place no additional reliance on 'buy-out' clauses arising on developments or rental guarantees unless the contracting party is of an 'undoubted' character and the contract is unconditional. Where in the rare case any reliance is so placed this should be made clear.

See GN 1

5.5 Valuations should make no allowance for taxation or expenses of realisation which may arise on a notional or actual disposal. The principles set out in Guidance Note GN1 concerning the valuation of contracts and options, should be followed.

5.6 The valuation of a Property portfolio will normally be the aggregate of the individual property values.

6. Frequency of Valuations

6.1 Where the Fund Managers calculate the price of the units of a Property Fund less frequently than once a month the Valuer should revalue immediately before each date on which the price is calculated and in any event at least once every twelve months, when he provides the Valuation Certificate for publication (see paragraphs 7 and 8).

6.2 If the price is calculated monthly or at more frequent intervals the Valuer should value all the properties once every month and only in the event of a material change would a shorter interval be appropriate. Every property should be valued immediately after purchase (but never before completion has taken place) and at any time when there has been a material change of facts or market conditions.

7. Publication of Valuations

7.1 The Annual Report and Accounts of the Property Fund should reproduce the year end Valuation Certificate/Certificates relating to all the properties in the Fund at the end of the accounting year.

7.2 The Fund Managers are responsible for acting on intermediate valuations made by the Valuer and these need not normally be published except when a Valuer's appointment ceases by termination or resignation (see para. 4.3).

8. Form of Valuation Certificate

See GN 5

8.1 The contents of the preamble to the Certificates are a matter for each Valuer but attention is drawn to Guidance Note No. GN 5.

8.2 The Certificate should state clearly the date of valuation, the basis of valuation, and any assumptions made (see para. 5). The Certificate should give the aggregate of the valuation of each of the properties and this total be sub-divided into the categories:

- (a) Properties held as Investments.

(c) Properties substantially vacant.

(d) Properties held for development in the future.

8.3 Each category should be sub-divided between freehold and leasehold. Overseas properties should be shown separately. The Valuer should draw attention to any significant holding in short leasehold interests. He should state the identity of the largest property and its proportion to the aggregate amount of all Fund properties he has valued.

8.4 It is not considered necessary that any details of the individual properties need be given in the Certificate. If the Certificate refers to all the properties in the Property Fund the Valuer should request the Auditors to check the accuracy of the identity of the properties he has valued.

8.5 If the Certificate applies to only certain properties (because e.g. another Valuer is valuing the remainder) it will be desirable to state this and indicate the properties included or excluded. The Certificate should contain a 'non-publication without consent' clause.

See GN 5

8.6 If in the Valuer's opinion there has been a material change in the aggregate value due to market changes or factors affecting a particular property or properties between the date of valuation and the date of the Certificate the Valuer should make an appropriate reference.

9. Developments

9.1 Developments should be valued in the state in which they exist at the date of valuation and any assumptions should be stated and explained.

9.2 Where information which is not within the Valuer's direct knowledge (e.g. the cost of completing a development) is needed to arrive at a value, such information should be obtained from an examination of the relevant documentation or from the professional adviser concerned.

10. Vacant Properties

Properties which are entirely or substantially vacant should be valued in their existing state and not on the basis that lettings might be completed, with a deduction for voids and expenses.

11. Overseas Properties

The valuation figure to be certified by the Valuer will be on the same basis as in the U.K. (i.e. open market value). The general principles relating to overseas valuations set out in Guidance Note No. 5 should be followed. As valuations are carried out in local currency the Fund Managers should be asked to arrange for a Banker to provide a letter giving the exchange rate to be adopted for conversion to Sterling on the valuation date.

See GN 5

12. Information on Property Assets and Changes

The publication of information on the property assets, changes and movements is the responsibility of the Fund Manager. The Valuer will need to compare any such published information with the facts known to him and as referred to in his Valuation Certificate to ensure that his valuation is based on correct advice.

13. Inspections

The frequency of physical inspections of the properties must be a discretionary matter for the Valuer. When properties are valued at short intervals it is not practical for inspections to be made to a similar timetable. It is recommended that the Valuer should have visited each property every year and that a full inspection should be made at least every three years. Arrangements should be made for the Property Managers to notify the

RICS Guidance Notes on the Valuation of Assets—2nd Edition**14. Sources of Information**

The Valuer should wherever possible verify the facts relating to a property and not rely on others. On the other hand he should not accept responsibility for matters which are the province of others. It is important, therefore, to state in the Valuation Certificate the information which is relied upon and not verified and by whom it has been supplied. Where other sources of information are relied upon the facts should be confirmed in writing, e.g. a Banker's letter on currency exchange rates (see para. 11).

Guidance Note No. GN 20

ASSET VALUATIONS IN ACCORDANCE WITH THE INSURANCE COMPANIES ACT 1974

1. When valuing assets of Insurance Companies it is necessary to comply with the terms of The Insurance Companies (Valuation of Assets) Regulations 1976 (SI 1976 No. 87) made under Sections 78 and 86 of The Insurance Companies Act 1974. (See Footnote)

The Regulations are effective from 1st May, 1976, and revoke SI 1974 No. 2203.

The Regulations apply to all general business assets, and all long-term business assets but unit linked property assets are excluded and subject to separate requirements. The Regulations apply to nine categories of assets: those likely to be of direct concern to members are 'Land' and 'Debts'. 'Land' includes land and buildings and any interest in land. An option to purchase is considered to be an interest in land and consequently must be valued.

The Regulations apply to all insurance companies authorised to carry on any class of insurance business in the United Kingdom.

Whilst Valuers will wish to read the Regulations as a whole, the following are probably of principal interest:

2. **Regulation 3**

2.1 Para. (4) provides in effect that the most recent 'proper valuation' made under Regulation 7 is a maximum. If the Valuer makes a qualification to the valuation (e.g. the absence of HAC has not been verified or some other adverse factor) a lower value may have to be adopted by the insurance company. If there has been a change in circumstances since the last 'proper valuation' (e.g. a change in market conditions with rising yields) which make it likely that the valuation figure is not realisable, then the appropriate lesser amount is to be taken.

2.2 This could mean in practice that an up-to-date revaluation may have to be made or further advice obtained and insurance companies can be expected to consult with their valuers.

2.3 Similar considerations apply to certain other categories of assets including 'debts' valued under Regulation 6.

3. **Regulations 4 and 5**

3.1 These Regulations concern the valuation of assets of dependents (as defined in Regulation 2(2)). If members are instructed to value assets of this category of companies they should consult with their clients as to the advice and valuations required to comply with the Regulations in the particular circumstances.

4. **Regulation 6**

4.1 This prescribes the method of valuing 'debts' which include mortgages.

4.2 If due within twelve months the value is the amount which can reasonably be expected to be recovered. This will include a debt which would become due within twelve months if the insurance company exercised any right to require payment.

4.3 If due beyond twelve months the value is the amount which would reasonably be paid for an assignment of the debt with the benefit of the security. Thus in 1979, for example, a standing mortgage of £100,000 for 20 years fixed at 7½% in 1965 would have fallen to be valued at a discount; consideration must also be given to the other conditions of the debt,

Note: These regulations should be read in conjunction with SI 1976 No. 2039 (which freed from the admissibility limits investments by insurance companies in Government and public authorities and increased the limit of admissibility set to certain debts from individuals) and SI 1980 No. 5 which enables insurers to elect, subject

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the status of the mortgagor and the nature of the security and the strength of the cover provided by it for the debt. Where the security is land members may be asked to comment on its nature and/or the value of the land.

4.4 Members may be asked to advise on the value of a 'salvage right' where the insurance company have a right to possess or sell an asset.

5. Regulation 7

5.1 This deals with the valuation of 'land'. The value to the insurance company for the purposes of the Regulation will not be greater than the amount obtainable (after deducting reasonable sale expenses) if the land were sold at the most recent 'proper' valuation. This basis is governed by Regulation 3(4) upon which comments are made above.

5.2 A 'proper valuation' is defined in Regulation 2 and is the amount realisable by an open market sale and must have been made not more than three years before the relevant date. This valuation must have been made by a 'qualified valuer' (see Regulation 2) viz. a person who is a Fellow or a Professional Associate of the Royal Institution of Chartered Surveyors (or a Fellow or an Associate of the ISVA or the RVA) who must have knowledge and experience in the valuation of land or by any other person approved by the Secretary of State for the Department of Trade.

5.3 As a 'person' can include any body of persons corporate or unincorporate it follows that a firm may or may not be a 'qualified valuer'. Where one or more of the partners is not a 'qualified valuer' the valuation must be made by, and the valuation report signed by, a partner who is a 'qualified valuer'.

5.4 It is recommended that the Valuer should produce the figure for the 'proper valuation' leaving the insurance company to assess the deduction for reasonable expenses of sale (according to the latter's judgement of the appropriate method of disposal). Members are advised to make it quite clear when submitting a valuation that it takes no account of the expenses of sale. Members should be prepared, if requested, to advise on the amount of sale expenses according to the circumstances.

5.5 The relevant date of valuation must be given to the Valuer by the insurance company.

5.6 It is to be noted that valuations do not have to be made by independent persons so that if they are 'qualified valuers' both directors and employees of the insurance company can undertake the valuation.

5.7 Land not so valued is excluded from being taken account of for the purposes of the Regulations (see Regulation 3(1)). This allows a company, if it so wishes, to exclude relatively small holdings.

5.8 Land occupied by the company is to be valued as if with the benefit of vacant possession; it would be wrong to value it on the basis of a sale as an investment with an assumed lease to the company at a rent.

5.9 Land is to be valued as free and clear of any mortgage or charge.

5.10 The Regulations cover land in the UK and overseas.

6. Regulation 8

6.1 This applies special valuation rules to equipment which includes 'plant and machinery'. Valuers in this field should note that the rules are severe and apply percentage deductions to a strict time scale on computer equipment and for all other equipment a minimum of 50% deduction on cost in the financial year of acquisition and a complete write-off thereafter. As the rules apply also to dependent companies it is important that Valuers consult with their instructing clients (see comments on Regulations 4 and 5).

6.2 In valuing an 'in hand' agricultural holding the basis of valuation of the land will assume vacant possession and it would appear that the operating capital (except for any item of plant and machinery acquired during the financial year) would have to be ignored.

... must be valued at the lower of the cost or the net realisable value. The same rule applies to work in progress must

6.4 Reference should be made to Guidance Note No. GN 25 as to those items of plant and machinery which are normally valued as an integral part of land and buildings and it follows that such items do not fall within the scope of this Regulation. See GN 25

7. Regulation 13

This Regulation provides for life interests to be valued as the amount which would reasonably be paid for an immediate transfer; it also expressly provides for leases and reversions to be valued on the basis prescribed in Regulation 7. It should be noted that reference in this Regulation to property includes all forms of property.

8. Schedule 2

This Schedule prescribes permitted limits for certain categories of assets in relation to the general business amount or the long term business amount (as defined in Regulation 15(2)). In this connection paragraph 1 should be noted by Valuers. This deals with the position where a valuation of a piece of land (other than land held as security for a debt) or a number of pieces of such land is greater than the aggregate of the valuations of each piece of land valued separately. This will cover the situation for example where the insurance company owns a number of interests (but not all) in a block of property or an island site, which is being assembled for development. Valuers can be expected, therefore, to be asked to advise on the 'lotting' of a portfolio to produce the highest proper valuation in order that the permitted limits can be tested.

9. The Signing of Valuation Certificates under the Insurance Companies Regulations

9.1 It is recommended that members should confirm in their Valuation Certificate that it is a 'proper valuation' made in accordance with the Regulations and the signatory is a 'qualified valuer' (see Regulation 7 above).

9.2 Care must be taken to ensure that the valuation is only signed by a qualified valuer.

9.3 The Institution is advised that where a partnership consists entirely of persons having the specified qualifications or corporate membership then the Valuation Certificate may be signed in the name of the partnership but this should also include a statement to the effect that all the partners have the specified qualifications.

9.4 If one or more of the partners is, therefore, not a corporate member of the Royal Institution of Chartered Surveyors, or the Incorporated Society of Valuers and Auctioneers or the Rating & Valuation Association the Valuation Certificate must be signed by the qualified valuer who has actually made the valuation and a statement included to the effect that the signatory is a qualified valuer within the meaning of the Regulations.

9.5 If the partnership consists entirely of corporate members of the Royal Institution of Chartered Surveyors or the Incorporated Society of Valuers and Auctioneers or the Rating & Valuation Association, the Valuation Certificate can still be signed in the firm's name, even though one or more of the partners may specialise in the valuation of categories of land other than that which is the subject of the valuation. In this event it must be understood that the actual valuation must have been made by a qualified valuer who has the appropriate knowledge and experience in valuing the subject land.

9.6 If the firm (and this may particularly apply in some overseas countries) is not a partnership but a corporate body then the signatory must be a qualified valuer, and a director or secretary, unless so qualified, may not sign the Valuation Certificate. In this case, it is also necessary for a statement to be made to the effect that the signatory is a qualified valuer within the meaning of the Regulations.

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9.8 It follows, therefore, that there should normally be only four forms of signature in accordance with the following examples:

(a) Smith, Jones and Robinson

(Where in this case every partner is a qualified valuer within the meaning of Regulation 7).

or

(b) (i) A. Smith or

**(ii) A. Smith
for Smith, Jones & Robinson, or**

**(iii) Smith, Jones & Robinson
A. Smith**

In cases (b) (i), (ii) and (iii) A. Smith being a qualified valuer within the meaning of the Regulations and the person fully responsible for the Valuation.

In both cases (a) and (b) The Valuation Certificate must include the statements as to qualifications referred to earlier.

It must not be overlooked that a partnership can contain as a partner a body of persons corporate or unincorporate and in that case the requirements will only be met by the application of examples (b) (i), (ii) or (iii).

REVIEWING OF VALUATIONS

1. Reviews of a Valuer's Previous Valuations

1.1 Valuers are often asked to carry out reviews of their previous valuations without undertaking a full reinspection of the properties. Valuers should be cautious in accepting such instructions and should have regard to the period of time that has elapsed since the last valuation. It would not normally be appropriate to accept such limited instructions where there has been a material alteration or change in the property portfolio, a material change in the property market, or a material change in the criteria previously adopted. Changes in rental income or other aspects of tenancies from investment properties would not normally be regarded as falling within the ambit of the foregoing circumstances.

1.2 Where such reviews are undertaken the Valuer is advised to obtain from the client a 'letter of comfort' stating that neither material alterations nor changes have taken place in the portfolio.

1.3 Where there have been material alterations or changes in the portfolio it will be necessary for the Valuer to undertake a valuation of those properties new to the portfolio or those where there have been alterations or changes.

1.4 When reporting the results of a review of a previous valuation the valuer is recommended not to refer to a 'desk study' or similar wording but to adopt the following, suitably amended to meet the particular circumstances:

'As instructed, we have reviewed our valuations of (date) without reinspecting (all) the properties and on the same criteria as previously used but under current market conditions we are of the opinion that the open market value as at (date) is of the order of £.....'

1.5 Where alterations and changes of a material or significant nature have occurred and a review has still been undertaken, these should be referred to in the review report.

2. Review of Valuations made by another party

2.1 A Valuer may be asked to review in whole or in part a valuation made by a director or internal valuer of the company which owns the property, or to undertake a review of a valuation by another external valuer.

2.2 A Valuer should not accept instructions to undertake a review of a valuation unless he made that valuation, in which case he should follow the recommendations above.

2.3 Unless the Valuer has already inspected the property concerned and is already familiar with the building and location or is afforded the opportunity of carrying out an inspection and has made all other relevant enquiries, or has been supplied with the information that would result from such enquiries, he is in no position to express an opinion as to value except on a restricted basis.

See GN 2

2.4 It is recommended that the Valuer should report his own valuation with such qualifications as may be appropriate. There should be no reference to any valuation prepared by another party as otherwise there may be implied criticism which would be unfair and possibly damaging to the other Valuer's reputation if he is afforded no right of reply.

See GN 17

2.5 Where a Valuer is instructed to carry out a valuation jointly with another Valuer, this would not be considered to be a review within the ambit of this Guidance Note, even though one of the Valuers may be an internal valuer.

See GN 3

EXHIBIT 9

FIRST ASSET REALTY ADVISORS
APPRAISAL ENGAGEMENT LETTER



Appraisal Engagement Letter - Preliminary Draft

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.
 - d. Buyer motivation is profiled as an assumption by the appraiser.

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. 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 possible.
4. The income approach must use discounted cash flow from a ten year forecast (and your own forecast if different) in which all major leases are detailed individually and minor leases classified into groups if appropriate. 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. 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 by 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 and evaluate a list of projects which are competitive alternatives in the market areas of the appraiser and indicate rent structures, vacancy rates, turnover rates, and in the case of the new building, coming on stream or about to be built, some indication as to their rentup success and the source of their tenants. Wherever possible the appraiser is to indicate the ownership and character of investment position in these competitive properties and the property management or leasing term involved with each.

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 (Item 4 & 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, with a separate quote for the initial appraisal, the 180 day review, and a 360 day reappraisal. 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.

NORTHWEST CENTER FOR PROFESSIONAL EDUCATION

SEMINAR ATTENDEE LIST
FOR 85168NYC

CONTEMPORARY APPRAISING/PENSION FUND
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09/26/1985 THRU 09/27/1985

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BUILDING 2; SUITE 300
ATLANTA GA 30328
404-255-1255

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ATTENDEE LIST, page 4
CONTEMPORARY APPRAISING/PENSION FUND, 85168NYC

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ONE NEW YORK PLAZA
NEW YORK NY 10004
212-747-3981
BANKER

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KORPACZ & ASSOCIATES, INC
29 MANOR ROAD
SMITHTOWN NY 11787
516-979-9465

SCHOTT, RIED
2850 DELK ROAD - 5C
MARIETTA GA 30067
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SHUMAKER, SALLY
CENTRAL MORTGAGE COMPANY
8704 PLYMOUTH ROAD
ALEXANDRIA VA 22308
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KAUSER WELSH SORICH & CIRZ
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HARTFORD CT 06106
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KIDDER PEABODY & COMPANY
10 HANOVER SQUARE
18 FLOOR
NEW YORK NY 10005
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TOWNLEY, CHRISTOPHER
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MIDDLETOWN NY 10940
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APPRAISER

Fourth Annual Conference
**Real Estate Investment Strategies
for Pension Funds**

Sponsored by the Utah State Retirement Board in conjunction with
Northwest Center for Professional Education

November 10-13, 1985

Ramada Renaissance Hotel
San Francisco, CA

October 28, 1985

BERT D. HUNSAKER
Executive Director
Utah State Retirement Board
Salt Lake City, UT

Dr. James Graaskamp
Landmark Reserch, Inc.
4610 University Avenue, Suite 105
Madison, Wisconsin 53705

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(503) 223-3921

Dear Jim:

The Pension Fund Conference in San Francisco, November 10-13, is now only two weeks away. Registrations are most encouraging -- we have 155 advisors and 121 sponsors registered, the largest response ever!

I am enclosing a Tape Release Form which gives us permission to record the audio segment of your presentation. Please sign and return this release to us at your earliest convenience. If you would like a complimentary tape of your presentation, check the box at the bottom of the form. We will be happy to send you a copy.

We would like to invite you to have lunch with Clem Laufenberg, Conference Manager, and the other Monday afternoon speakers in the Milan Room of the Hotel on Monday, November 11, at 12:30 p.m. We hope you will be able to attend.

Don't forget the tour and champagne party at the Embarcadero Center on Sunday afternoon. We are hoping for a large turnout for what we consider one of the highlights of the conference this year. If you are planning to attend, please call our Bellevue office at 1-800-426-5575 to RSVP. We need to know the number of people attending since we are providing transportation from the Ramada Renaissance to the Center.

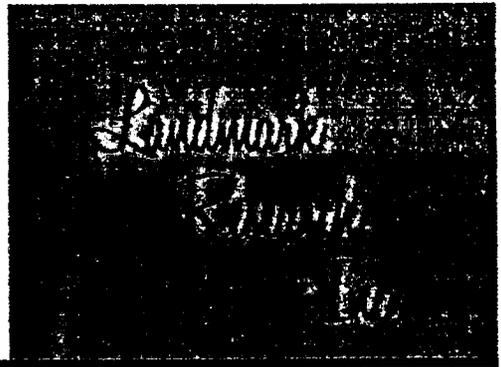
We will be in touch with you again shortly before the conference.

Sincerely,



Darlene Carlson
Program Manager

DC:d
Enc.



James A. Graaskamp, Ph.D., S.R.E.A., C.R.E.
Jean B. Davis, M.S.

May 13, 1985

Norman P. Swent, Executive Director
Northwest Center for Professional Education
13555 Bel-Red Road
C-96870
Bellevue, WA 98009

Dear Paul:

Here are the two one-day course outlines I promised. Let me know if there is more detail required.

Please send a note confirming the various dates for the fall-winter road show as I seem to have misplaced your note.

Best regards,

JAMES A. GRAASKAMP