improvements. Any alterations to be made during the term of the Lease are subject to the Trust's written consent. Alterations generally become the property of the Trust and remain at the expiration of the Lease, except that the Trust may require the alterations to be removed at GE Aviation's expense.

7. Mr. Rhoades was retained by GEIC to act as an independent fiduciary for the Trust in connection with the Lease. Mr. Rhoades is president of the real estate appraisal and consulting firm of David P. Rhoades & Associates, Inc., of San Francisco, California. Mr. Rhoades represents that he and his firm are independent of, and unrelated to, GE and its affiliates. Mr. Rhoades states that he is a Member of the Appraisal Institute (MAI) and has 22 years experience as a real estate appraiser dealing with the valuation and analysis of all types of property, including urban office buildings similar to the Property. Mr. Rhoades has acknowledged in writing that he is a fiduciary for the Trust and that he understands his duties, responsibilities, and liabilities as a fiduciary under the Act.

8. Mr. Rhoades reviewed the Lease and inspected the Property prior to the transaction. In an appraisal dated July 6, 1994, Mr. Rhoades concluded that the market rent for the space covered by the Lease would be in the range of \$19.00 to \$21.00 per square foot. Thus, Mr. Rhoades determined that the proposed average rental rate under the Lease of \$20.22 per square foot would be at the upper end of the range of rents for comparable leases in the San Francisco area and would not be less than the fair market rental value for the space. Mr. Rhoades states that the terms of the Lease are comparable to the terms that would have been negotiated in arm'slength transactions between unrelated parties. Mr. Rhoades concluded that the Lease would be in the best interest of the Trust because it would yield the Trust a market rate of return, would avoid additional leasing efforts, and would avoid the lost revenue and associated costs of having the space remain vacant.

Mr. Rhoades represents that the tenant improvement allowance for the Lease of \$42.50 per square foot was necessary because of the unimproved condition of the particular space. Mr. Rhoades states that the space on the 27th floor leased by GE Aviation was previously demolished in connection with work that was done for another tenant, who currently occupies part of the 27th floor and the two floors above the 27th floor. In this regard, the applicant represents that the 27th floor space previously was occupied by Bank

of America, which had been a major tenant in the Building from 1981 through 1991. The entire 27th floor, when occupied by the Bank of America, was primarily open space with movable partitions. At the time the Bank of America vacated the 27th floor space, substantial work on the space was needed to satisfy applicable legal requirements, such as current fire and safety codes. In addition, the Bank of America's use of the space was not readily adaptable to a new tenant desiring up-to-date conventional office space and was functionally obsolete. Consequently, the applicant states that it was cost effective to demolish the entire floor when work was being done for a new tenant that would occupy half of the 27th floor and to re-build sufficiently to meet the minimum requirements for the entire floor, including the part that was not yet being leased. As a result, when the other half of the floor was leased to GE Aviation, it was in unimproved condition. Thus, prior to the Lease, the space was effectively "first generation" or unimproved space which required relatively high outlays for tenant improvements.

Mr. Rhoades states that the improvements made to the space leased by GE Aviation are functional and reusable by a wide range of tenants without major costs, and are typical of the types of improvements landlords usually build for such tenants. Mr. Rhoades maintains that the residual value of the tenant improvements at the end of the Lease (i.e. 5 years) will be about 50 percent of the original cost of the tenant improvements, or approximately \$21.25 per square foot.

9. With respect to the overall rate of return to the Trust under the terms of the Lease, Mr. Rhoades conducted an analysis of both the "internal rate of return" (IRR) and the "net present value" (NPV) to the Trust from the Lease

Mr. Rhoades represents that the "rate of return" on a real estate investment is the ratio of income to the original investment and the "IRR" is the annualized rate of return on capital that is generated within an investment over a period of ownership. 15 Thus, the IRR measures the returns from an investment in relation to the original capital outlay. In this case, Mr. Rhoades states that the "returns" consist of the rental income over the Lease term and the pass-through of certain expenses after the first year, as well as the

residual value of the tenant improvements at the end of the Lease. The "original capital outlay" consists of expenses relating to the leased space, including the tenant improvements, operating expenses, brokerage fees, parking, and taxes. This "original capital outlay" was approximately \$421,920.

In addition, Mr. Rhoades states that the "NPV" is the difference between the present value of all expected investment benefits, or positive cash flows, and the present value of capital outlays, or negative cash flows, over the entire period of the investment. The present value calculation involved in determining NPV requires the use of a specific discount rate, which operates as the annual rate of return objective. In this regard, Mr. Rhoades used the standard real estate industry rate of 9 percent for the NPV calculation, which provided a basis for comparing the rate of return on the Lease to different leasing arrangements in the Property.

Mr. Rhoades states that his approach to evaluating leases and leasing costs is customary in the real estate industry. Mr. Rhoades states further that he was consistent in using this approach to evaluate the comparable leases in the Building and other comparable properties for purposes of determining the fair market rental value of the space under the Lease as well as the IRR and NPV of the Lease to the Trust. However, Mr. Rhoades notes that his approach did not consider the original cost or value of the Building in evaluating the specific leases. In this regard, Mr. Rhoades has confirmed that it is not customary to consider the cost or value of a building for this purpose because the focus in valuing a lease is on the incremental costs and income of the lease and the ongoing costs relating to the space.

Based on an extensive analysis and comparison of the terms of the Lease to all other leases in the Property at the time of the transaction, Mr. Rhoades concluded that the Lease had a greater NPV and would yield a higher IRR than any other lease of a comparable term in the Property. Mr. Rhoades represents that the Lease will yield an IRR to the Trust of approximately 10.83 percent on an annual basis and has a NPV of \$4.87 per square foot based on a discount rate of 9 percent, when taking into account the residual value of the tenant improvements. Therefore, Mr. Rhoades states that it is unlikely that the Trust would have obtained a lease for the space on more favorable terms from

¹⁵Mr. Rhoades cites *The Dictionary of Real Estate Appraisal* (3rd edition) as his source for the definition of these terms.