



# HIGHEST & BEST USE ANALYSIS

BY ROBERT TIPPLE, AACI, FELLOW

We all know what highest and best use is – or at least we know enough to think of it as ‘maximum potential use.’ Of course, there is a process to be followed, but this is not about the process – this is about the analysis, which is part of the process.

We sometimes tend to think of the highest and best use in terms of current use and that can lead us to form a conclusion that might be ‘inconclusive’ to the client. An example of this would be a 40-year-old former ‘gas station’ – the ones that used to be common – with

fueling pumps outside and two or three vehicle repair bays inside. It may well be that, for physical, economic and environmental reasons, continuation as a ‘gas station’ may no longer be the highest and best use of this property. However, are we providing the best advice to our client if we conclude that demolition of the building and redevelopment of the site is the highest and best use? That may be so, but not necessarily, since many of these properties remediate the contaminated sites, retain the buildings and renovate them so that they have

a new life as convenience stores and/or fast food takeouts (usually service stations were in great locations).

What about a 50-year-old neighbourhood supermarket that looks tired inside and out, its heating, electrical and A/C systems are totally out of date, and the parking lot is decrepit. Should the building be demolished and the site redeveloped ‘as permitted by current zoning?’ Maybe, but maybe not. It is usually outside the scope of an appraisal to complete a cost/benefit analysis that compares refurbishing

a building to the cost of new construction. But, consideration should at least be given to informing the client that there are options. By the way, that 50-year-old tired supermarket is now a modern and attractive office building.

Another example would be a fairly large national chain auto repair garage that became the victim of the shift in retail from being near residential areas to being within ‘big box’ areas. It is easy to quickly conclude that, if a national chain decided that this property is no longer suitable for its retail use, the property is ready for a change in use from retail. Again, maybe so, but for one thing, retail is one of many forms of commercial use and we likely do not have the information to conclude that retail is or is not a highest and best use. Therefore, we should avoid using the term ‘retail,’ and instead use the more generic term ‘commercial.’

Second, we should not be unduly influenced by one property user, even if that user is very well known and established.

Third, we should consider all the factors which affect highest and best use – physical, legal, economic – and inform the client that, subject to cost, the subject property may have alternate uses, possibly alternate commercial uses, but, potentially, other types of use

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depending on zoning and permitted uses. It may even be that the current use is a legal non-conforming use and, if so, this should definitely be identified and addressed so that the client is fully informed.

What happened to that former repair garage? Using the existing building steel frame, it was totally refurbished into three separate rental spaces, each occupied by national companies, none of them having anything at all to do with vehicle repair.

The above are only three examples that should make us think carefully and be thorough in our analysis of highest and best use. It is this analysis that clients seek in our valuation reports. So, how can we provide a more meaningful analysis that will better serve our clients?

When we are completing our inspection of the property, be diligent, because the information we are obtaining on-site is important and forms part of the basis for our highest and best use analysis and conclusions.

When writing our report, specifically the property description section, state the relevance of what is being described, rather than simply providing a factual description. Clients are relying on us to inform them of what we are thinking.

Use the description section of our report to provide the basis for the highest and best use section. ‘Connect’ them. For example, the condition of the building and the location of the property, as stated in the description section, should be among the physical factors referred to in the highest and best use analysis.

Remind ourselves that highest and best use is a very important component of our report in that it effectively determines the property being appraised and forms the basis for its valuation. That is to say, is the property a tired building that has reached the end of its physical life, regardless of other factors, or is it a tired building that has adaptive use potential?

Clearly address highest and best use of **both** the site as-if-vacant and highest and best use of the improved property. The benefit of our report to the client is that it provides our opinion of the ‘maximum potential use’ of both the site and the improved property based on a combination

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of factual information, our knowledge and our experience.

When completing our analysis, specifically consider physical, legal and economic factors as they relate to the property being appraised. This includes the usual description and condition of the property, as well as zoning and permitted uses. But, equally important are local market development trends, demographics, rental rates, costs of construction, costs of renovation, availability of financing and others.

Above are three examples that should make us think carefully and be thorough in our analysis of highest and best use. To our profession, these are the technical issues that are part of the work we are trained to do, but, to our clients, the analysis of these factors is the essence of what they seek in our appraisal reports. It is the value – pardon the pun – of our reports to the clients, many of whom (e.g., lenders or out-of-town investors) may not have seen the properties and are relying on us to provide the analysis they require for important decision-making. Highest and best use is critical to the number, or range of numbers, which we refer to as ‘value’ at the end of our report.

#### **About the author**

Robert Tipple, AACI, Fellow (Retired) is a long-time member of the Appraisal Institute of Canada who served as an AIC Board member and as Director for NL. He retired from private practice in 2010, but has continued to contribute to AIC as a member of the Nominating Committee and as a peer reviewer. 🇩🇪