

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

A. Appraisal Organizations

8. 1976

d. "Highest and Best Use", SRA Chapter 73  
Meeting, June 27, 1976

SRA Chapter 73 Meeting  
June 27, 1976

HIGHEST AND BEST USE, PRINCIPLE OF - Real Estate Appraisal Principles and Terminology, by SRA, Second Edition 1971

A valuation concept that can be applied to either the land or improvements. It normally is used to mean that use of a parcel of land (without regard to any improvements upon it) that will maximize the owner's wealth by being the most profitable use of the land. The concept of highest and best use can also be applied to a property which has some improvements upon it that have a remaining economic life. In this context, highest and best use can refer to that use of the existing improvements which is most profitable to the owner. It is possible to have two different highest and best uses for the same property: one for the land ignoring the improvements; and another that recognizes the presence of the improvements.

HIGHEST AND BEST USE - Real Estate Appraisal Terminology, by SRA, 1975

That reasonable and probable use that will support the highest present value, as defined, as of the effective date of the appraisal.

Alternatively, that use, from among reasonably probable and legal alternative uses, found to be physically possible, appropriately supported, financially feasible, and which results in highest land value.

The definition immediately above applies specifically to the highest and best use of land. It is to be recognized that in cases where a site has existing improvements on it, the highest and best use may very well be determined to be different from the existing use. The existing use will continue, however, unless and until land value in its highest and best use exceeds the total value of the property in its existing use. See Interim Use.

Implied within these definitions is recognition of the contribution of that specific use to community environment or to community development goals in addition to wealth maximization of individual property owners.

Also implied is that the determination of highest and best use results from the appraiser's judgment and analytical skill, i.e., that the use determined from analysis represents an opinion, not a fact to be found. In appraisal practice, the concept of highest and best use represents the premise upon which value is based. In the context of most probable selling price (market value) another appropriate term to reflect highest and best use would be most probable use. See Most Probable Use, Most Profitable Use.

## Exhibit B continued

## VII. Productivity or potential use analysis of subject property

## A. Site analysis

1. Physical (static) site attributes including location, size, shape, slope, soils, etc.
2. Legal constraints on use of site including zoning, easements, or those implied by purpose of appraisal (purpose for use as a bank drive-in teller facility must be a specified distance from main bank building).
3. Linkages of site to neighborhood and community (visual and physical relationships to flows of people, traffic, goods, or activity centers).
4. Dynamic attributes of site (behavioral responses of people to site in terms of anxiety, special attractions of water, view, etc., visibility, prestige, etc.

## B. Improvement analysis

1. Physical (static) attributes of improvements listed by type, construction, layout, condition, etc.
2. Legal-political constraints on use of improvements (including problems of non-conformity, building code violations, zoning, etc.
3. Current uses and tenancies, if any
4. Linkages of current uses to neighborhood and community
5. Potential linkages or attributes which could be marketed (feasibility problem of a property in search of a market)
6. Dynamic attributes of improvement (behavioral responses of people to building style, bulk, sentimental history, historical values, etc.

## C. Identification of significant and physically appropriate uses for subject property

## D. Comparative analysis to select most probable use as of valuation date considering:

1. Effective market demand
2. Competitive supply of alternatives
3. Legality and political compatibility
4. Financial feasibility
5. Risk sensitivity

## VIII. Specification of most probable buyer type implied by most probable use of subject property.

## A. Alternative buyer types and motivations and selection of most probable buyer profile.

## B. Specification of essential site, improvement, financial, or other key decision criteria of probable buyer type.

## C. Explanation of appraisal methodology for prediction of probable purchase price range consistent for most probable buyer.

1. Preferred method - to infer buyer behavior from actual market transaction and market data available.
2. In the absence of adequate market sales data, the alternative method selected for simulation of probable buyer decision process
3. The text proposed to indicate the fit of property and probable price prediction to be made to the criteria of the probable buyer profile.

## EXHIBIT B

### SUGGESTED OUTLINE OF A BASIC APPRAISAL REPORT

- I. Letter of Transmittal
- II. Table of Contents
- III. Salient facts and conclusions (optional and relevant to purpose of appraisal)
- IV. Statement of context for which appraisal is required:
  - A. Brief statement of the issue for which the appraisal will serve as a decision benchmark.
  - B. Special problems implicit in the property which specify definition of value or modify appraisal methodology.
  - C. Special instructions or assumptions provided by others and approved by client (for example, a request to appraise current use rather than best use, or a request for investment value rather than probable sales price, etc., or special assumptions required for cash flow projections by state securities commission).
- V. Definition of the legal interests to be appraised
  - A. Specify legal description and source
  - B. Specify fixtures or personalty to be included
  - C. Specify typical operating assets excluded (such as furniture when doing a motel structure for a real estate tax).
- VI. Definition of value to be objective of appraisal
  - A. State selected definition (for example the R.U. Ratcliff definition of probable price):

"The most probable price is that selling price which is most likely to emerge from a transaction involving the subject property if it were to be 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."
  - B. Indicate source of definition and applicability to purpose of appraisal
  - C. Indicate implicit conditions of the definition. (For example, the conditions of a fair sale presumed by fair market value or the implication of the range of error around most probable price implied by the Ratcliff definition).

## Exhibit B continued

## IX. Initial estimate of appraised value

## A. Inference from market transactions of similar buyers

1. Search and data collection method
2. Definition of basis for comparison
3. Adjustments and supporting evidence
4. Extrapolating comparative sales to subject property
5. Estimate of central tendency of value and standard error prior to adjustments for external of changing condition

## B. Simulation of possible or probable buyer logic in establishing his offer price

1. Justification for using simulation rather than market comparison
2. Justification for simulation methods selected
3. Description of the basic simulation approach
4. Development of data required for simulation
5. Estimate of most probable simulation value
6. Identification of "softest" assumptions to which value is sensitive
7. Pessimistic and optimistic assumption sets to establish range of alternative values

## X. Identification of significant external conditions, economic, political, or otherwise, not considered by past market transactions or investment simulation based on empirical evidence.

- A. Identify neighborhood, community, regional, or national factors which would bear directly on marketability of such a property and which were not present in market comparison or simulation assumptions.
- B. Identify possible political or other contingent factors which might foreseeably occur to upset normal appraisal assumptions.
- C. Specify any violation of conditions in the appraisal methodology of the definition of value.
- D. Adjust initial value estimate in IX or indicate no adjustment is necessary.

## XI. Demonstrate with test previously indicated how predicted transaction price would permit investor to achieve objectives attributed to him in definition of most probable buyer profile.

## XII. Provide value conclusion and certification of appraisal

## XIII. Provide statement of limiting conditions which establish:

- A. Contributions of other professionals on which report relies
- B. Facts and forecasting under conditions of uncertainty
- C. Assumptions provided by the client
- C. Controls on use of appraisal imposed by the appraiser

## XIV. Appendices and Professional Credentials