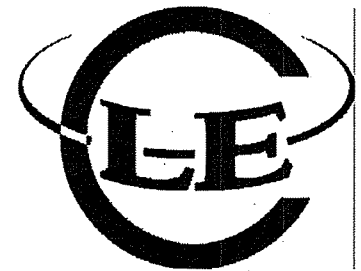




Highest and Best Use

Valuation Traps and Pitfalls
John Peebles AACI



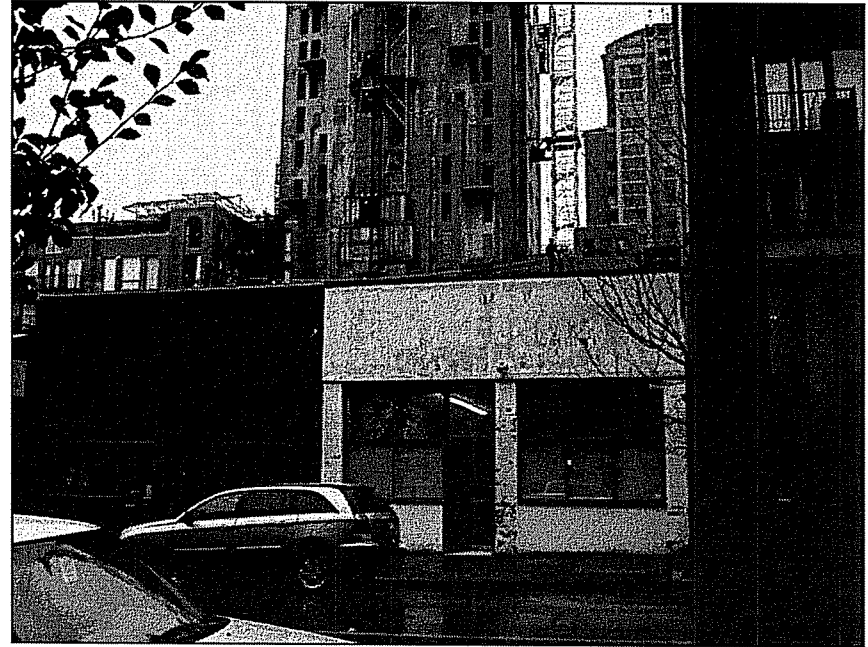


Presentation Overview

- HBU Analysis is Market Research
- Why HBU Errors can be Fatal
- Example 1 – HB Political Use
- Example 2 – One Use Too Many
- Example 3 – Will it be Vacant or Improved?
- Example 4 – Excess or Surplus – Same Diff?

HBU defined

- ❑ HBU is founded on classical economic principles
 - individuals are rational
 - buyers and seller well informed, acting prudently
 - Individuals act out of self-interest & seek profit maximization
- ❑ HBU of real estate is the probable use that provides the maximum profit (measurable)
- ❑ The key to unlocking HBU is market research



HBU Analysis Provides Insights to Owner Behaviour:

- Why do owners maintain derelict properties?
- Should I convert the property to another, more profitable use?
- Should I renovate or demolish?
- Do I have excess land?
- How should I value the property?

10/24/2007

Why HBU errors can be fatal

Appraisers can forget that HBU and MV are inseparable since:

- ☐ MV & HBU rely on same definition of competitive market conditions
- ☐ MV & HBU both assume profit maximization and rational behaviour
- ☐ HBU is basis for Market value

Wrong HBU may lead to:

- ☐ incorrect valuation methods)
- ☐ selection of the inappropriate market data

Result: Conclusion not Credible



HBU concepts that may be ignored

Consistent use

The land and improvements of a property can only have one HBU (blgs 'wedded' to land)

Interim Use

Improvements that do not represent HBU may have still short-term value

Excess Land

Land not needed to support the existing improvement, or for vacant site land not needed to accommodate the sites primary highest and best use (e.g. excess parking area)

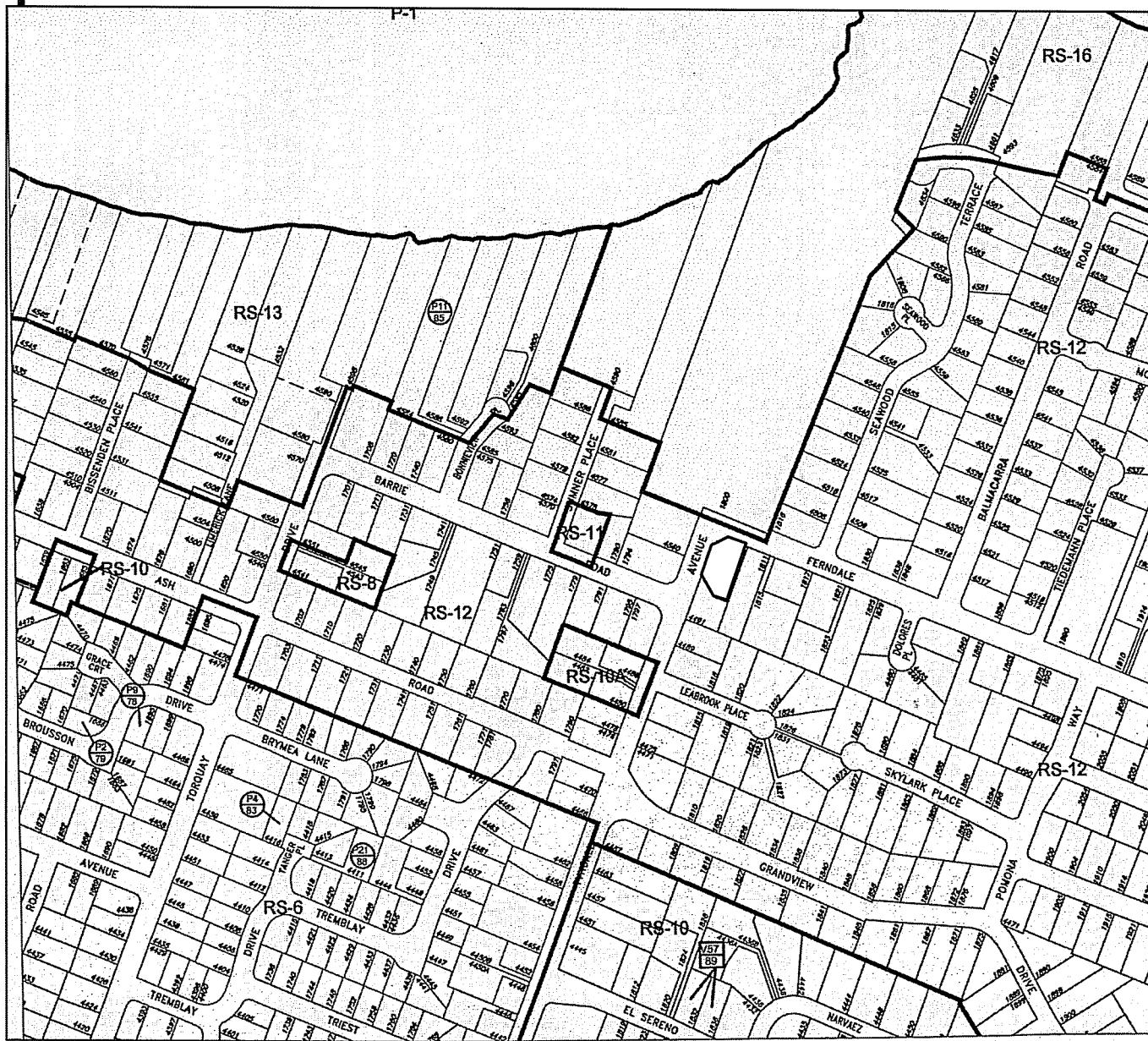
Value in Combination

Site HBU may be in combination with adjacent lands.

HB Political Use

- ❑ Residential Property in Saanich
- ❑ Established area of older houses & larger lots
- ❑ Large level but irregular corner lot
- ❑ Improved with 1920's era 1600 ft² cottage
- ❑ Fronts on minor arterial road – all services available
- ❑ Legacy of panhandle lots in NBHD
- ❑ What is the HBU? What are the use options?
 - current use
 - subdivide, demo house, and sell vacant lots
 - subdivide and keep house
- ❑ What questions should be addressed to test HBU?

HB Political Use



HB Political Use



Gordon Head: Corner of Tyndall Ave & Ferndale Road

HB Political Use

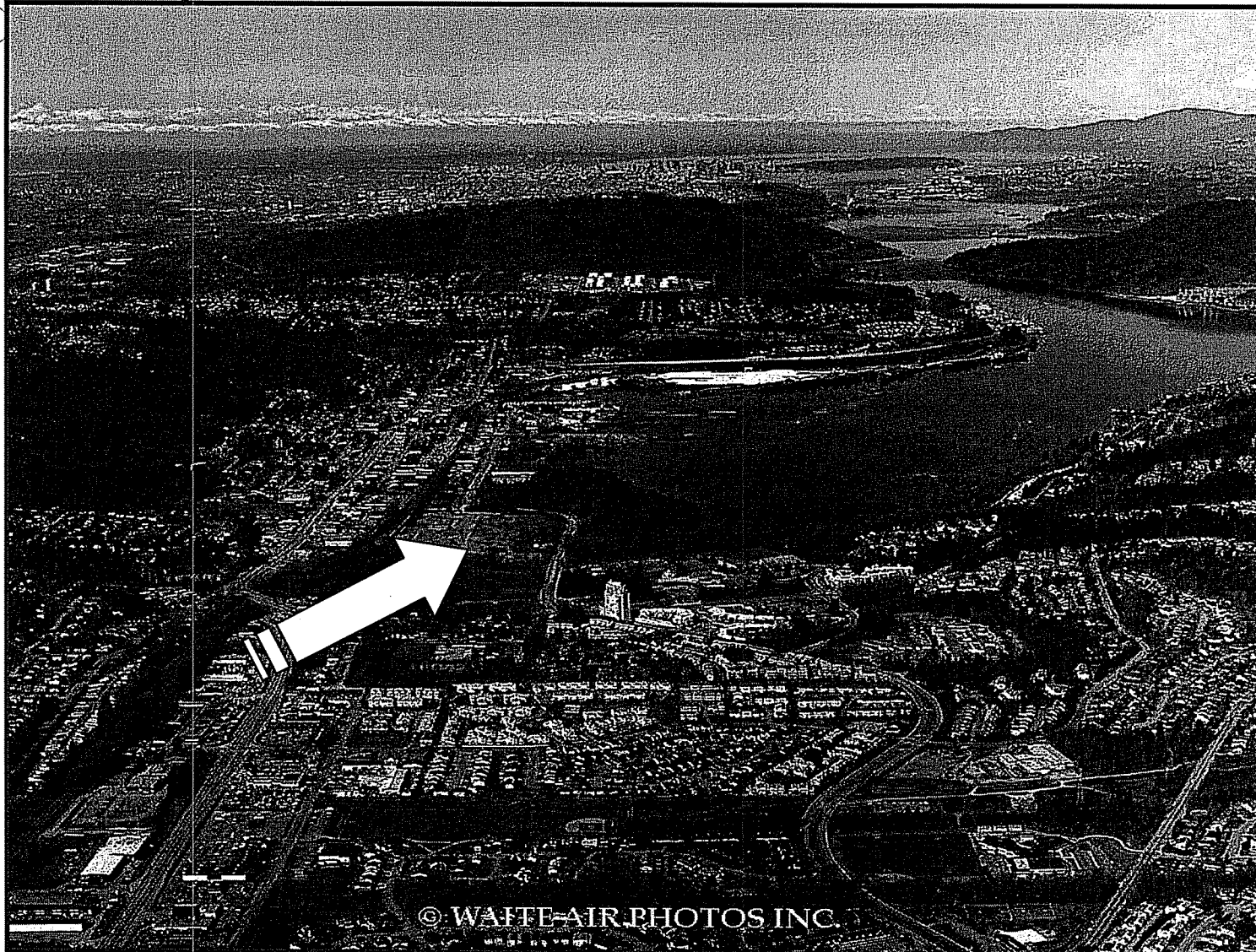
- Saanich OCP calls for increased density within Urban Containment Area
- Lot size – 14,405 ft²
- Current Zoning RS12 - 10,010 ft² (72 ft width)
- Possible Zoning RS8 - 7158 ft² standard lot (59.1 ft width)
- RS8 has been achieved elsewhere in NBHD
- House on south half of lot (Tyndall Rd frontage) – 7158 ft² min RS 8 could be technically achieved

HB Political Use

- ❑ Market Information for Vacant & Improved Analysis:
 - 5-6000 ft² building lots selling for \$350,000+
 - new housing on in-fill lots selling for \$650,000+
 - very strong demand in Gordon Head area
 - value of existing property is about \$550,000
 - survey & subdivision expense estimated at \$20,000
 - demolition & cost for hook-ups estimated at \$20,000
- ❑ Renovation of existing housing common in area.
- ❑ Several in-fill projects have occurred within 2-3 blocks.

Rezoning and Subdivision is a clear financial winner for HBU...what is missing?

Case Study – Consistent Use



Case Study – Consistent Use



Case Study – Consistent Use

- Port Moody: former IPSCO site (Sky-Train Fabrication Yard)
- near CPR & waterfront area Port Moody
- Site area of 27 acres (net area for re-dev 16 acres)
- M3 Zoning (heavy industry)
- OCP calls for mixed use res
- 3-yr lease for current use
- Land rent was \$364,000 /yr
- **2001** market conditions were very soft for condos

2001 Actual Value Appealed to Property Assessment Appeal Board

Land \$3,902,000

Improvements \$7,657,000 (only 1 yr old as of July 1, 2000)

Question: is the HBU industrial or alternate use?

Case Study – Consistent Use

Arguments

- Assessor said HBU is re-development site but valued improvement at full replacement value less accumulated depreciation
- Appellants: agreed with Assessor on land but said improvements had no value since use was temporary (

Assessment Appeal Board Decision

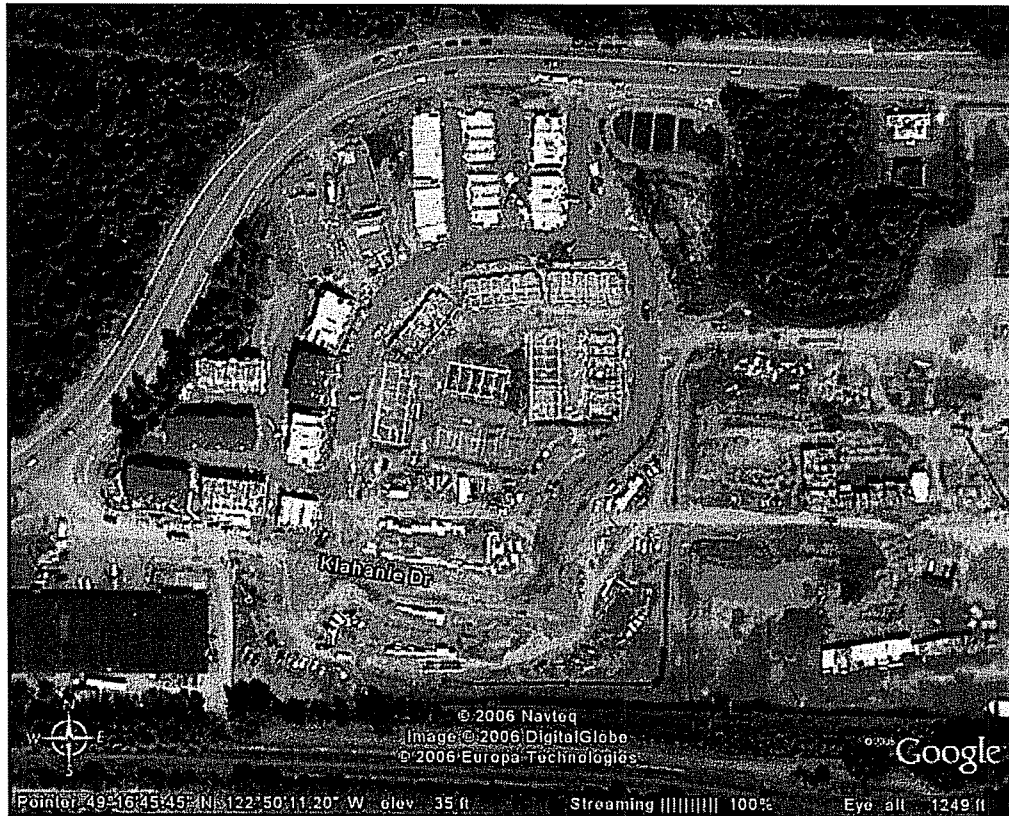
- **incorrect** to have separate HBU for land and improvements
- current use was an interim use and has value; accelerated depn applied
- highest and best use was re-development in next 2-3 years

Actual value

Land	\$5,400,000 (value as dev land)
Improvements	\$3,596,000 (interim value)

Case Study – Consistent Use

- IPSCO property sold to Polygon Homes for **\$12.5 million** in 2002
- Property now zoned CD-28 Mixed Res-Commercial Use



Testing HBU as Vacant & Improved

- ❑ Vacant Office Building Yates St Victoria
- ❑ Former BCBC Regional HQ (FSR of 1)
- ❑ Downtown Fringe in transition
- ❑ FSR of 5 to 6 being achieved in NBHD



Testing HBU as Vacant & Improved



Testing HBU as Vacant & Improved

- ☐ Property is vacant
- ☐ Design difficult to renovate (former bowling alley)
- ☐ Adjacent property represents under-utilization of site
- ☐ Periphery of Harris Green Neighbourhood Plan
- ☐ No off-street parking
- ☐ Portion of site density transferred years earlier

Options:

1. Apply economic rent and lease-up allowance.
2. Treat as development site. What would be built?
3. Assume investor would renovate and obtain higher office rents and retail rents.

What's the solution??

Why test HBU as vacant and improved?

- ❑ An investor wants to know which is more profitable
 - to hold property “as is”
 - to demo and re-build, or modify existing improvements
 - if re-building, what type of improvements should be built; and
 - what should be the timing of development
 - what are risks associated with various options?
- ❑ Existing improvements may not contribute to value of underlying land
- ❑ Required by AIC Standards

Excess or Surplus Land

Hillside Mall



10/24/2007

[illegible]



Excess or Surplus Land

Appeal Issue:

- does surplus or excess land exist on Sears component of mall?

Approach: HBU Research and Analysis

- starting point: area of parking required to support the mall
- what are trends with community malls and local NBHD trends?
- if parking in excess of requirements, is it surplus or excess?
- in-depth market analysis required to answer question

Current Status

- 2006 mall re-development announced by owners
- In City approval process

Closing Notes

- ❑ Covered some common HBU pitfalls
- ❑ HBU and Market value are inseparable concepts
- ❑ HBU requires is really real estate research and requires critical thinking
- ❑ Probability of use is key factor in HBU
- ❑ Risk tolerance can help explain why property may not be built out to maximum HBU (e.g., density)

Resource

http://www.notaries.bc.ca/images/stories/PDF/ScrivenerMagazine/2005_winter/scriv_dec_2005%2026.pdf