

# Finance 673

## Real Property Valuation

Department of Finance  
Mays Business School  
Texas A&M University

Highest and Best Use

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### Definition

- The reasonable probable and legal use of vacant land or an improved property that is physically possible, appropriately supported, and financially feasible and that results in the highest value
- Four tests
  - ▶ Legally permissible
  - ▶ Physically possible
  - ▶ Financially feasible
  - ▶ Maximally productive

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### HBU as though Vacant

- Legal permissibility
  - ▶ Analysis of zoning
  - ▶ Probability of zoning change
    - History of rezonings
    - Comprehensive plan
  - ▶ Environmental regulations
- Physically possible
  - ▶ Consider parcel size, shape, terrain, etc.

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### **HBU as though Vacant (continued)**

- Financially feasible
  - ▶ Of the uses that are legal and physically possible, which are financially feasible
  - ▶ For income producing uses
    - Feasible if income greater than operating expenses, debt service, required return to equity
  - ▶ Non-income producing uses
    - Feasible if value greater than the amount needed to develop and market property

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### **HBU as though Vacant (continued)**

- Maximum productivity
  - ▶ Analysis of financially feasible uses
  - ▶ HBU is use that produces highest land residual
  - ▶ Land residual analysis
    - Value of proposed use (land and buildings) less development cost (and profit) equals land residual
    - Overall value (Vo) - cost = land residual (VL)
    - Quantity left over

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### **HBU as Improved**

- Identify renovations, rehabilitation, conversion (re-use), change of use
- Legal permissible
  - ▶ Whether subject conforms to existing regulations
  - ▶ Evaluate existing improvements
- Physically possible
  - ▶ Existing use is
  - ▶ Modifications possible

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## **HBU as Improved (*continued*)**

- Financially feasible
  - ▶ Continued market demand
  - ▶ Are changes feasible?
- Maximum productivity
  - ▶ Are costs of any indicated changes justified?
  - ▶ Which change allows greatest value (net after cost)
  - ▶ Usually conclude existing uses are HBU, unless they no longer contribute value, and alternative use of land has high enough vlaue to justify demolition cost

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