

LINCOLN INSTITUTE OF LAND POLICY  
National Conference of State Tax Judges  
42<sup>nd</sup> Annual Meeting  
Cambridge, MA  
October 27-29, 2022

---

**Understanding Highest & Best Use Principles**  
Speaker: Gary J. McCabe, CAE  
Muddy River Advisors

## Property Assessment Valuation, Third edition (IAAO)

“The concept of highest and best use is one of the most important and least understood principles in real estate appraisal. The highest and best use of a property, more than anything else, determines its market value. It provides conclusions that guide the appraiser in the application of the three approaches to value.”

Property Assessment Valuation Third edition  
Garth E. Thimgan, CAE Editor  
International Association of Assessing Officers  
Kansas City, MO  
2010

## Property Assessment Valuation, Third edition (IAAO)

“The highest & best use for appraisal or assessment purposes can be defined as that use or the succession of available, legal, and physically permitted uses with enough demand to produce the probable present value of a property.” “The highest and best use must be a use that generates the highest net return over a reasonable period of time.”

## Property Assessment Valuation, Third edition (IAAO)

“The highest & best analysis is not intended to be an exhaustive analysis of every possible use for the subject property. Rather, it is intended to provide sufficient analysis of the most likely and most reasonable alternatives for the subject property.”

“A highest & best use study tells the appraiser what value is directly proportional to the use of the property.”

# Highest & Best Use Basic Tests (IAAO)

A highest & best use study consists of four basic tests that must be examined for both vacant and improved properties is. Is the proposed use:

1. Legally permissibly
2. Physically possible
3. Financially feasible
4. Most productive

The four criteria are like a filtering system and should be considered in sequential order.

## Fee Simple Interest: Bundle of Rights (IAAO)

The Assessor typically values real property as an estate in fee simple. The *bundle of rights* represent ownership of all the legal rights obtained with fee simple title.

1. The right to sell
2. The right to lease or rent
3. The right to use
4. The right to give away
5. The right to enter or leave (real property)
6. The right to refuse to do any of these.

## Assessed Value = Market Value

The basis for fair market value for assessment purposes in Massachusetts has been defined as,

*“the price an owner willing but not under any compulsion to sell ought to receive from one willing but not under compulsion to buy.” “The fair cash value is the value this property would have had on January 1 of any taxable year in the hands of any owner, including the present owner.”*

*Boston Gas Company v. Board of Assessors of Boston, 334 Mass. 566 (1956)*

# Real Property Interest: MGL (Tax Credit)

Massachusetts General Laws Chapter 62,

Section 6: Income Tax Credits (donation of deed restrictions)

- (p)(1) As used in this subsection the following words shall, unless the context clearly requires otherwise, have the following meanings:--
- "Interest in real property", any right in real property in the commonwealth, with or without improvements thereon, or water including, but not limited to, fee simple, life estate, restriction, easement, covenant, condition, partial interest, remainder, future interest, lease, license, mineral right, riparian right or other interest or right in real property that may be conveyed concerning the power to transfer property.



## Value in Use and Value in Exchange

From *Property Assessment Valuation* 3<sup>rd</sup> ed. IAAO 2010

The concept of value in exchange accentuates the subjective element and holds that value is within the mind of man.

In an economic sense, the primary concern for the assessor is value in exchange because it indicates the actions and reactions of buyers, sellers, and investors.

## Value in Use and Value in Exchange (cont.)

From *Property Assessment Valuation* 3<sup>rd</sup> ed. IAAO 2010

A property may have one value in use and a significantly different value in exchange.

The concept of value in use rests on the objective premise that value is within the object itself.

When a property is utilized at its highest and best use, its value in use and its value in exchange are the same.

## Value in Use and Value in Exchange (cont.)

Massachusetts Supreme Judicial Court -

*“If fair cash value cannot be ascertained by reference to sales of comparable property, it is proper to determine fair cash value from the intrinsic value of the property, including ‘any and all of the uses to which the property is adapted in the hands of any owner’.”*

*Mashpee Wampanoag Indian Tribal Council v. Board of Assessors of Mashpee, 379 Mass. 420 (1980)*

- Underlying issue: Deed Restriction

## Highest & Best Use Appraisal Principles (IAAO)

In any highest & best use study, the majority if not all the appraisal principles come into play and should be a factor in an appraiser's final determination of the highest & best use of the subject property.

- 1) Anticipation
- 2) Surplus Productivity
- 3) Balance
- 4) Supply & Demand
- 5) Change
- 6) Substitution
- 7) Competition
- 8) Consistent Use
- 9) Conformity
- 10) Increasing & Decreasing Returns
- 11) Progression & Regression
- 12) Contribution

# Highest & Best Use Principles (1/5)

- **Anticipation:** Value is created by the anticipation of benefits to be received in the future.
- **Surplus Productivity:** Because of location, one parcel may produce twice as much income to the land as a similar parcel in a different location. If two parcels are used for identical purposes and are similar in their labor, management and capital requirements, but one, because of its location, produces greater income than the other, then the difference in net income will be capitalized entirely into differences in land values.
- **Balance:** The process of analyzing the market to see if there is a proper mix of types and uses of property.

# Highest & Best Use Principles (2/5)

- **Change:** Market forces that influence value: physical (environmental), economic, social and governmental are constantly changing which in turn can change the highest & best use of a property. Because of this principle, an estimate of a property's highest & best use is only valid as of a specific date (the date of the appraisal).
- **Substitution:** Market value of a property tends to be set by the cost of acquiring an equally desirable and valuable substitute property, assuming no undue delay is encountered in acquiring the substitute property.
- **Competition:** Competition is created by the potential for profits. Availability must be in harmony with demand. If one or the other is in excess, prices will increase or decrease.

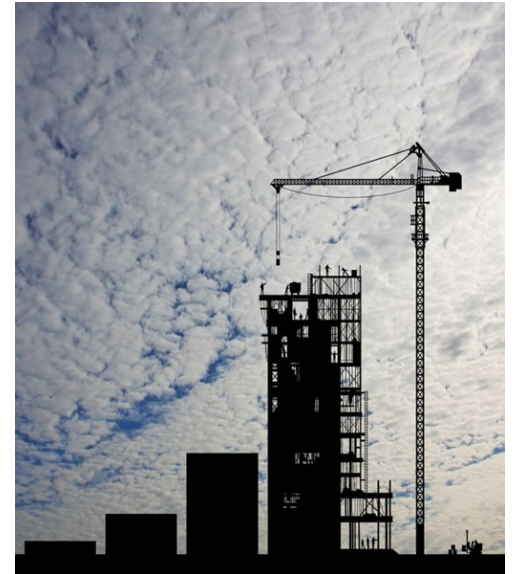
## Highest & Best Use Principles (3/5)

- **Consistent Use:** This principle states that a property must be valued with a single use for the entire property. Land cannot be based on one highest & best use and the improvement based on another highest & best use.
- **Conformity:** The highest & best use depends on the subject property's relationship to its surroundings. Value is created and sustained when the characteristics of a property conform to the demands of the market. This principle restates the principle of externalities which says that the value of real estate, because of its fixed location, is influenced by forces outside of the property boundaries.

# Highest & Best Use Principles (4/5)

- **Increasing and Decreasing Returns:**

This principle states that when successive increments of one agent of production are added to fixed amounts of the other agents, future income or amenities will increase to a certain point. After reaching a certain point, the addition of successive increments of one agent of production will decrease future incomes and amenities. The point at which the process of increasing returns reaches the maximum is theoretically its highest & best use.





# Highest & Best Use Principles (5/5)

- **Progression and Regression:**
- The principle of progression states that association with better properties of the same type increases the value of a lower priced property.
- The principle of regression states that association with lower quality properties in the same area decreases the value of a better quality property.

## Estimating Remaining Economic Life [IAAO] (1/2)

“The remaining economic life of the improvement, in most cases, is something less than the remaining physical life. Within the same improvement-use type location is an important consideration in the determination of economic life. For many uses, economic life in a large, fast-growing, and relatively new city is much shorter than economic life expectancy for the same property use in an older, smaller city.”

## Estimating Remaining Economic Life [IAAO] (2/2)

“In determining the period during which the improvements continue to contribute to total property value, the appraiser must consider not only the present condition of the improvement but also other known factors that might affect its future use or desirability, such as the condition of nearby property. Utility (value) is subjective and exists in the mind; usefulness is objective and inherent in the property.”

## Valuation Premise & the Income Approach

Massachusetts Supreme Judicial Court -

*“While it is true that results obtained under the capitalization of income approach should reflect what a willing buyer would pay a willing seller, it is not necessary that the rate of return element of the valuation equation be derived directly from the market sought to be analyzed. The only requirement is that the rate derived ‘should reflect the return on investment necessary to attract investment capital’.”*

*Board of Assessors of Brookline vs. George V. Buehler - 396 Mass. 520 (1986)*

- Underlying issue: Rent Control

## Cost vs. Value

“It is noteworthy that the cost or sacrifice necessary to create a good or service is *not* an essential element or characteristic of value. Although cost is accepted, subject to certain important limitations, as a measure of value, it is not essential to nor a cause of value. Taxation for ad Valorem purposes means taxation according to value and not according to cost.”

### Valuation of Railroad and Utility Property

Arlo Woolery, CAE

Lincoln Institute of Land Policy, Cambridge, MA (1992)

# Creating Better Uses: Special Districts

The Smart Growth Zoning Overlay District Act, Chapter 149 of the Acts of 2004, codified as M.G.L. chapter 40R (the Act), encourages communities to create dense residential or mixed-use smart growth zoning districts, including a high percentage of affordable housing units, to be located near transit stations, in areas of concentrated development such as existing city and town centers, and in other highly suitable locations. Projects must be developable under the community's smart growth zoning adopted under Chapter 40R, either as-of-right or through a limited plan review process akin to site plan review.

Development financing typically includes Low Income Housing Tax Credits (LIHTC).



# What Does a 40R Development Look Like?

- **Wellesley Office Park:** 26 +/- acres along the Charles River at Route's I-95 (Rt.128), I-90 & Rt.9 on border with city of Newton.
- Eight Office Buildings built between 1961-1984, with 649,000 gross square feet of office space and 1,900 surface parking spaces.
- Zoned Administrative & Professional.
- Owned by John Hancock Life Insurance Company
- Approved 40R Project: **The Nines**,
- 550-600 Luxury Apartments,
- 20-25% Affordable
- Mixed Office (575,000 sf.)
- Retail (75,000 sf.) & 150 Room Hotel



LINCOLN INSTITUTE OF LAND POLICY  
National Conference of State Tax Judges  
42<sup>nd</sup> Annual Meeting  
Cambridge, MA  
October 27-29, 2022

---

**Understanding Highest & Best Use Principles**  
Speaker: Gary J. McCabe, CAE  
Muddy River Advisors