

Highest and Best Use Analysis

St Albans Town Hall

579 Lake Street

Introduction

The first step in valuation of real estate is to complete a Highest and Best Use Analysis. The analysis acts as the foundation to an appraisal by estimating how much value can be derived from a piece of property. Typically, Highest and Best Use is used when evaluating vacant land. There are times when Highest and Best Use may develop a change in use of an existing structure.

Highest and Best Use involves four criteria for which the property must meet in order to establish value.

- 1) Physical Possibility- In a nutshell can you physically do what you want to the property.
- 2) Legal Permissibility- Is the proposed use legal under all governmental regulations.
- 3) Financially Feasible- Does it make sense to use the property as proposed from a financial analysis angle.
- 4) Maximum Profitability- Does the use maximize the current property to squeeze as much value from the property as possible.

Highest and Best Use is a supported argument looking at all potential uses then providing the pros and cons of those potential uses. Support data shows the conclusions make sense, are legal, and provides maximum profit.

Description

The Subject is approximately 130 years old and originally used as a school. That use was changed to its current use as the Town Offices. In 2010 a waste water permit was issued for the building providing for up to 330 gpd and up to 22 employees. A study of the building was completed in 2015 which revealed some deficiencies but overall found the building to be in average condition. The current floor plan includes the first floor Town Clerks office, vault, and conference room. There is also one handicapped bath. The building first floor is ADA compliant with a handicap ramp. The second floor is accessed via stairs in the front of the building and fire escape to the rear. Offices upstairs are open for the most part with three private offices. The building has 2810 sf on the first floor and 2,712 sf on the second floor.

Because of the age of the building there is much built-in functional obsolescence. This is commonly found in town halls through out the state where it is not unusual to have a town office in a converted school. Because of the built-in functional obsolescence, (the vault as one example) the net usable space is roughly 80 percent compared to a more modern facility.

The Subject is located in Mixed Residential/Commercial District. Zoning allows for a number of limited uses not subject to town review and a significant number of other uses that are conditional and must be approved by the Town. The Subject is currently a nonconforming preexisting use. Set backs and lot coverage limits are therefore legal as long as the building footprint and use is not changed. As part of this analysis, an extraordinary hypothetical condition is necessary.

Extraordinary Hypothetical Condition: *Without the knowledge of a zoning decision, it is assumed that the interior of the building can be modified to all conditional uses.*

Physical Possibility

The Subject is pre-existing and effectively can not be expanded in any way. Conversion to other uses may be realistic. For this analysis two uses have found to have merit for further consideration. Office or related and Apartment.

First Floor: The configuration of the first floor would allow for offices to be utilized with moderate expense. The space that currently occupies the Town Clerk office would need to have a bathroom installed. The most obvious area for a half bath would be next to the existing bath where the kitchenette is located. Some electrical upgrades would also be needed. While the property is not located in a downtown setting as found in St. Albans City, if the property was rented at a discount, it is likely two tenants would be attracted to the property because of the location within walking distance to The Bay Park, Lake Champlain, a restaurant and convenience store.

Second Floor: The wide-open floor plan opens up the possibility of a myriad of uses from office to studio to apartment. One limiting factor is the septic which will be analyzed under legal permissibility. If the use was converted to apartments interior renovations would be required including partitions, electrical, plumbing and flooring. Access is present by way of a front stairway and emergency egress is present at the rear with an outside fire escape. Again, all cited uses would benefit from the location near Lake Champlain.

Legal Permissibility

This analysis is subject to the hypothetical condition that the property would pass muster for all conditional uses listed. The Subject includes 22 parking spaces, which is more than would be required under the current zoning for office on the first floor and apartments on the second floor. The current WW permit allows for 22 employees and a flow rate of 330 gallons a day. There are currently 9 employees on site and while the building at capacity could hold in excess of 22 employees, that number would be considered a maximum considering the functional deficiencies noted. Current state septic guidelines call for minimum effluent flow of 120 and 240 gallons per day for a one bedroom and two-bedroom apartments respectively. The second floor of the building includes approximately 3,000 square feet of space. The average size of a one-bedroom apartment is 700 square feet while a two bedroom is 1,000. (Source: Yardi Metrix) Recognizing functional obsolescence of roughly 20% brings the total rentable space to 2,400 square feet. Considering the current partition configuration, it is reasonable to conclude that three one-bedroom units would be appropriate. Also given the current build out of new apartments, approximately 90 percent of all new units are one bedroom. (Source: Chittenden County Developers). The general reason is rents are approximately 12 percent more for two bedrooms while space allocated is roughly 40 percent higher.

Due to the current requirements for septic flow the only use available under current state guidelines is for office. The second floor is deemed to be flex space.

Financial feasibility

Currently rents for office space are between \$8.00 & \$11.00 triple net*. This means in the current configuration the space has a PGI (potential gross income) of \$33,100 to \$45,500. Effective PGI including vacancy allowance and rental loss arrives at \$31,500 to \$43,200 effective gross income. After expense including insurance, management and reserve for replacement, the net effective income would be approximately \$25,000 to \$34,500. Utilizing a capitalization rate of nine percent arrives as a potential value from \$277,000 to \$383,500. Prior to use as two offices, some partition work would be required. It is estimated that the cost would not exceed \$50,000. With changes the potential value for the Subject would stand at approximately \$225,000 to \$330,000 for the first floor. The second floor, as is would only be rentable to one entity due in part to the access and bath room layout. Because of the layout, lease rates would be in the range of four to five dollars per square foot or \$1,000 to \$1,250 per month. Utilizing the same rental adjustments as the first floor arrives at a potential contributory value of \$11,440 to \$14,250 per year net. Applying the capitalization rate of nine percent arrives at a contributory value of between \$127,000 and \$158,000. Total potential value for the property leaving it largely unchanged shows a value between \$350,000 and \$485,000.

If the town could upgrade the septic to include roughly 600 gpd, the second floor would be available for apartment rentals. In this case the value of the second-floor units would be in the \$300,000 to \$350,000 range. Add that to the value of the first floor with renovations results in a value of roughly \$525,000 to \$680,000. Cost associated with the change to apartments would be substantial. It is estimated that the cost would be anywhere from \$100,000 to \$200,000. Applying these costs results in value of approximately \$325,000 to \$580,000. As renovated into apartments and office appears to have the largest upside return (\$105,000). The town may choose to pay for an initial site assessment which would cost approximately \$1,000. If the flow rate can be achieved the town could either pay for a system design or market the property as having the potential for 600 gpd.

The town could benefit up \$100,000 by having a site assessment completed. The cost, at roughly \$1,000, represents a one percent investment in the potential value increase by using the Subject as an office/apartment use.

Maximum Profitability

This category looks at the potential uses and any other use that would benefit the property to a greater extent. This section is most often found in vacant land determination because of the many variables that can impact maximum profitability of a property as vacant. Maximum profitability is either three office/flex spaces or as two offices with three one-bedroom apartments. In the event the highest and best use includes apartments costs could potentially impact that use. Currently construction expenses are at the highest level ever recorded in Vermont. It is likely a purchaser of this type of property would have assets in place to reduce the renovation expense.

Conclusion

The exercise of determining highest and best use is generally related to the appraisal of property. This highest and best use analysis is for general decision making on how to best market the property once the town makes a decision on what to do with the property. The Subject is believed to be an historic building and changes to the façade or foot print is very limited. The current use of the property closely

mimics the highest and best use unless the property was purchased with the intended conversion of the second floor to living units. It is recommended that the Selectboard allocate funds to determine if the property could be converted to apartments, and that doing so would increase the potential selling price of the property.

- Triple net rent is defined as the lessee being responsible to all expenses except for building insurance and reserve for replacement.

Respectfully submitted,

Bill Hinman, Assessor