

**2020 Annual Conference Rapid Fire Session –  
Highest & Best Use Dairy Case Study**

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# REVIEW OF HIGHEST & BEST USE



## 1. What is Highest & Best Use

- Definition of Highest & Best Use: The reasonably probable and legal use of vacant land or improved property, which is physically possible, appropriately supported, financially feasible, and that results in the highest value.<sup>1</sup>

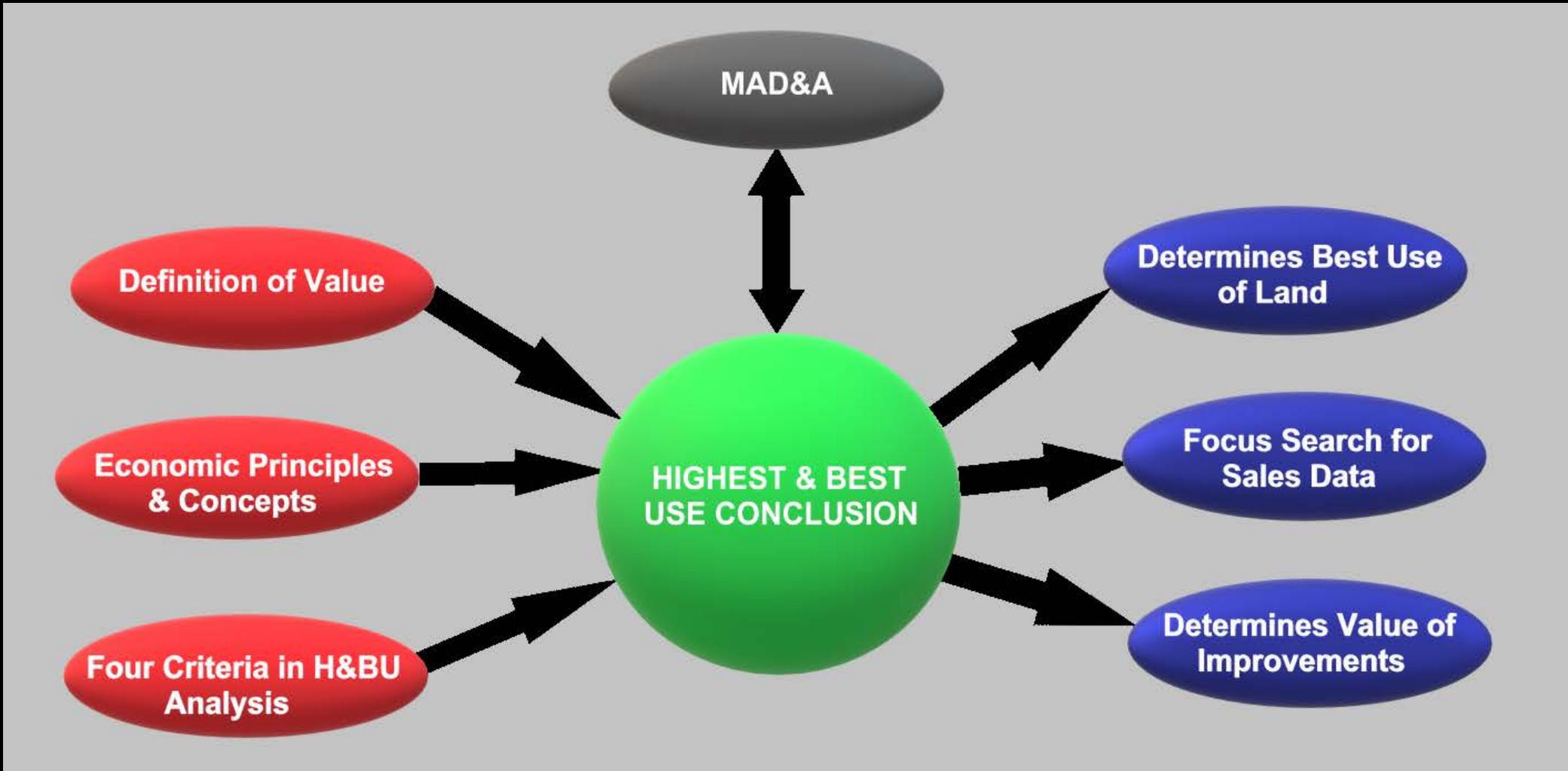
## 2. Importance of highest of best use

- a. HBU statement must align with your definition of value.
- b. HBU conclusion helps identify your market area and focuses your sales data searches.
  - i. Market Area Description & Analysis (MAD&A) – reveals key influences affecting the value of the subject and the appraiser’s level of knowledge using boilerplate descriptions.
  - ii. MAD&A should *contextualize* the valuation of the subject and only include data relevant therein.

<sup>1</sup> Highest and best use. (2010). The Dictionary of Real Estate Appraisal (p. 93, 5th ed.). Chicago: Appraisal Institute.



- c. HBU requires identifying likely deficiencies and / or the contribution of the existing improvements:
  - i. Demolition
  - ii. Renovation
  - iii. Expansion
  - iv. Conversion
  - v. Continued use as-is
  
- d. HBU can lead to serious ethics complaints, such as the following from a survey of bank reviewers:
  - i. Calling the HBU a dairy, but then valuing the property as open farmland.
  - ii. Valuing a property near a municipality as transitional land but concluding the HBU is Ag.
  - iii. Concluding one specific HBU when there can or are many, i.e. industrial park.
  - iv. Lack of a full HBU analysis, and instead providing a two-sentence statement. There are varying expectations for HBU.
  - v. Appraiser concluded irrigated cropland as it had once been irrigated. Upon reading the report and looking at the photos, it was discovered the property's water rights had been sold and the property had not been irrigated in years.





### 3. Highest & Best Use Analysis

- a. HBU is determined separately for the land or site as though vacant and available for its HBU because the land use can be limited by the presence of improvements. Think dairies v. almonds.
  - i. Land value is derived from potential land use as land has limited value unless there is a present or anticipated use.
  - ii. Analysis of the HBU of a property as improved implies that the existing improvement(s) should be renovated or retained so long as it continues to contribute to the market value of the subject, or until the return from a new improvement more than offsets the cost of removing the existing improvement.
  - iii. If a more profitable use must be delayed due to a lack of demand today, then the interim use will continue until such time that the value of the land as though vacant, minus the cost to remove existing structures, exceeds the property's current use as improved. This is known as interim use. Think dairies v. almonds again.



b. Four Criteria in Highest & Best Use Analysis:

i. Legally Permissible:

- Local zoning ordinances, water rights, conservation easements, etc.
- Environmental regulations via government agencies such as the State Water Resources Control Board and San Joaquin Air Pollution Control District.

ii. Physically Possible:

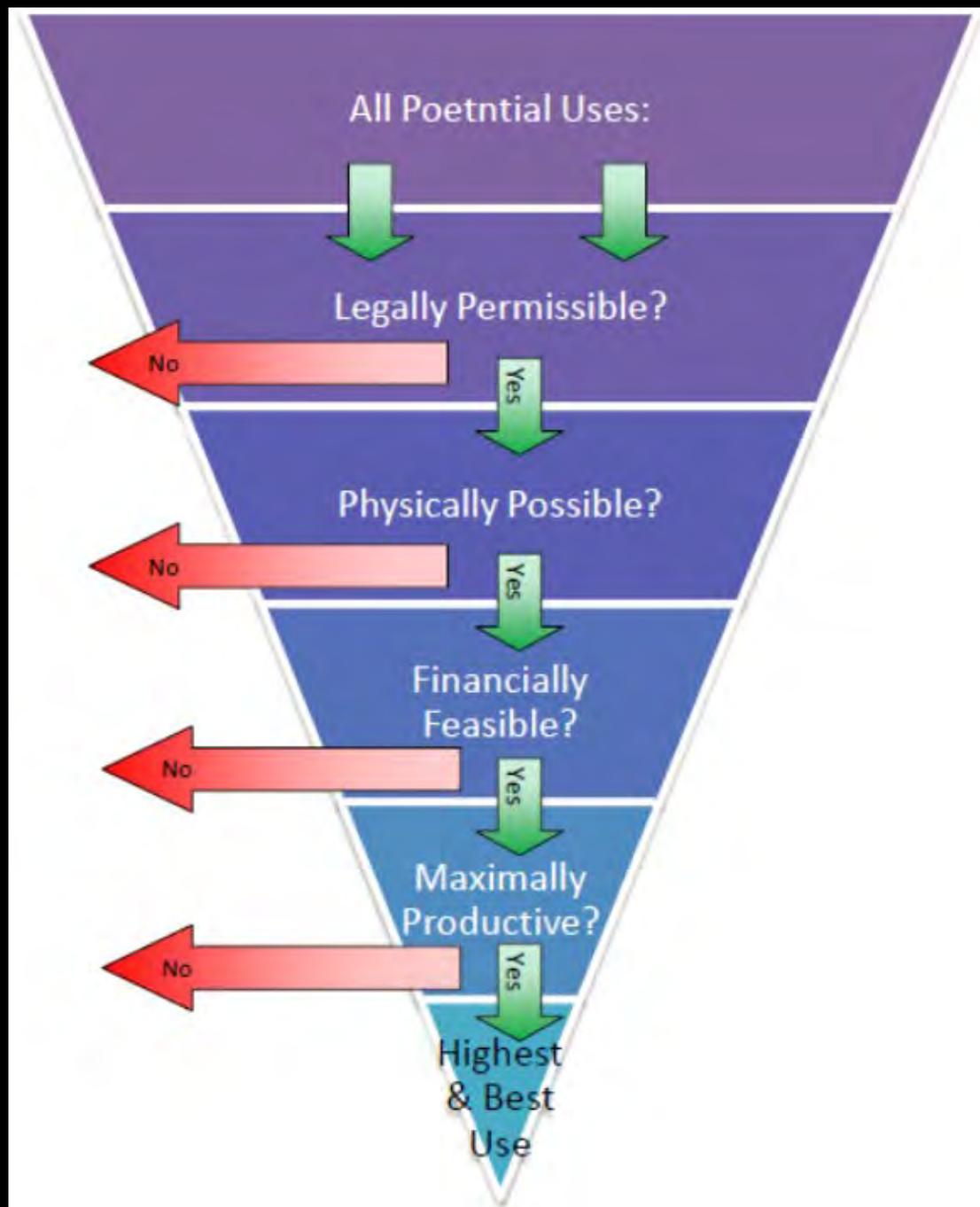
- Soil, topography, and drainage conditions with respect to permanent planting development.

iii. Financially Feasible:

- Uses that will generate a positive net income.

iv. Maximally Productive:

- Of the uses that are legally permissible, physically possible, and financially feasible, which one produces the greatest return / value.





## CASE STUDY – DAIRY, REPLACEMENT HEIFER FEEDLOT, PERMANENT PLANTINGS...?

### Pertinent Facts:

- Land Use: 143.43 total acres: 121 acres irrigated cropland and 22.43 acres of facility site, farmsteads & support. Of the 22.43 acres of facility, etc.,  $\pm 14\frac{1}{2}$  acres can potentially be reclaimed and made plantable.
- Irrigation water source: Class I surface water – 3+ Acre-feet in most years.
- Soils: 84% loamy sand, slightly saline-alkali, CU Illw-4, SI 57, and 16% sandy loam, slightly saline-alkali, CU Ilw-3, SI 60.
- Building Improvements: *Main Dairy*: Double-12 parabone milk barn, three flushed freestall barns totaling 606 freestall beds, maternity / special needs shade pen, three sets of open corrals, two hay barns, commodity barn, concrete feed slab, 3,000+ SF (4:2) main dwelling with pool & pool house, 1,247 SF (3:1) tenant dwelling, and lagoon. *Feedlot*: 54-bed freestall barn, open loafing corral, lagoon, and a 1,344 SF (3:1) & 1,032 SF (3:2) tenant dwellings. Total linear-feet of feed stanchions is 2,500'. Overall condition is fair-to-average, effectively 25-years-old, remaining economic life of 15-years.

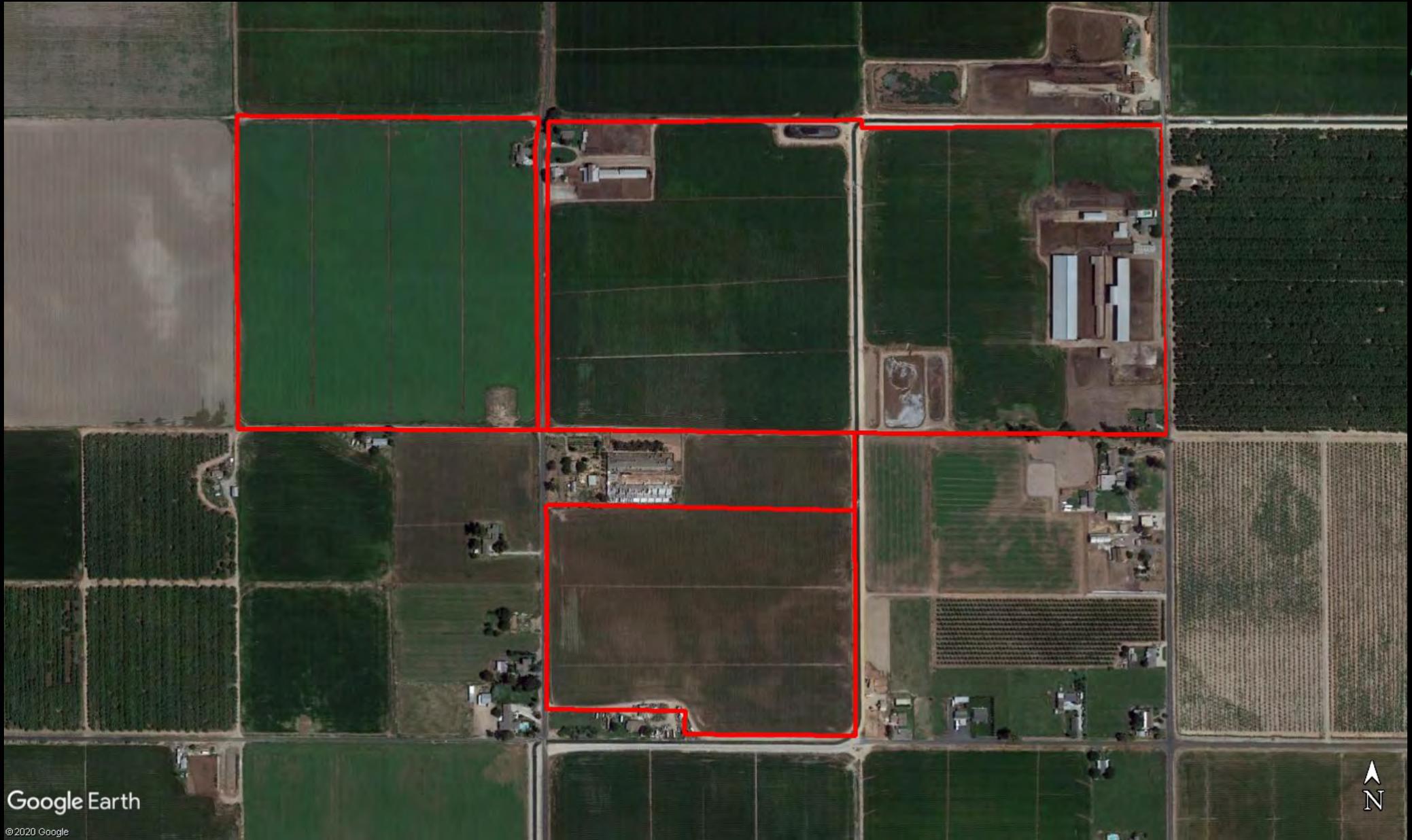


## CASE STUDY – DAIRY, REPLACEMENT HEIFER FEEDLOT, PERMANENT PLANTINGS...?

Pertinent Facts, continued:

- Zoning & Legal Capacity: Grand fathered county status with AG zoning. Permitted for 759-mature-cows (milking and dry) total, up to 873-mature-cows at the 15% pre-expansion limit mature cows via Water Board.
- Physical Capacity: Can reasonably accommodate 759-milk-cows and most support and young stock.
- Tenancy: The two parcels improved with dairy facilities totaling 76.60 acres, and 57.40 net acres of cropland, are leased for \$16,000-per-month, which equals \$500-per-farmable-acre and \$18-milk-cow-per-month based on 759-milk-cows with three-years remaining.
- Market Area: Permanent planting adaptable land values: \$28,000 - \$34,000/ac. Non-permanent planting adaptable land values: \$18,000 - \$25,000/ac. Dairy and permanent plantings (almonds) have the greatest influence in this market.

# SUBJECT AERIAL



Google Earth

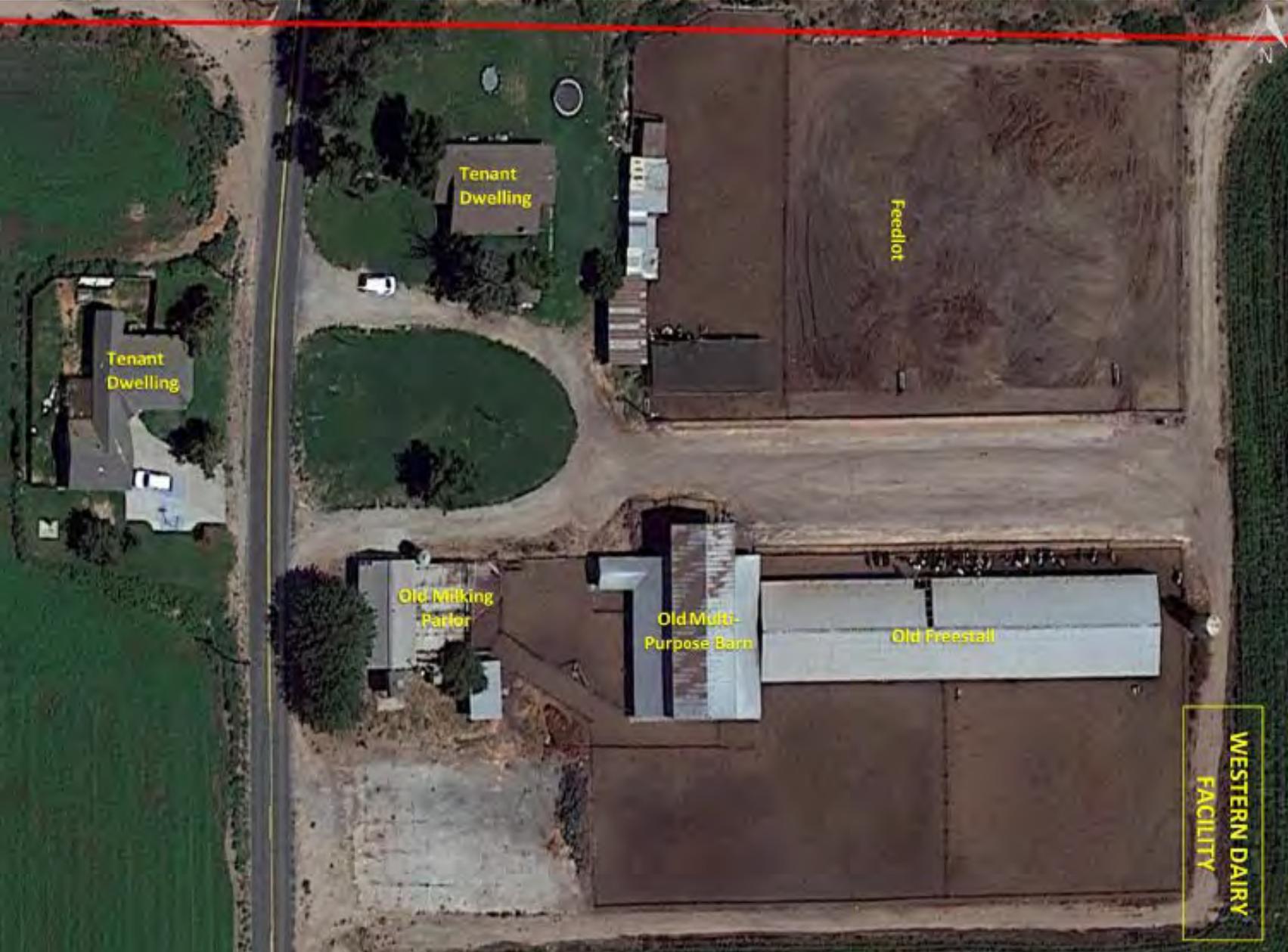
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# FACILITY PLAT



# FACILITY PLAT



# SUBJECT PHOTOGRAPHS



Milk Barn



Milk Parlor



East Freestall Barn



Center Freestall Barn



West Freestall Barn



Open Corrals & N. Hay Barn

# SUBJECT PHOTOGRAPHS



Commodity Barn



Main Dwelling



East Facility Tenant SFR



West Facility Tenant SFR



West Facility Tenant SFR



West Facility Heifer Corrals



# SUBJECT PHOTOGRAPHS



Lagoon



Typical View of IFC



## HIGHEST & BEST USE ANALYSIS

### AS IF VACANT

Legally Permissible – vacant use is consistent with County’s AG zoning allowing for parcel sizes more than 40 acres, and a variety of uses such as irrigated cropland, permanent plantings, ag facilities (with certain governmental approvals), and the allowance to construct both residential or farm/ranch buildings. Lack of market demand for homesites coupled with the subject dairy's need for all available irrigated cropland for effluent waste management precludes subdividing the subject into 40-acre parcels. Additionally, the subject has the right to receive surface water deliveries from the irrigation district.

Physically Possible – vacant use of the subject property supports physical possibilities of the legally permissible uses, as the surrounding area is developed to similar uses. Soil types, water supply, topography, and climatic conditions in the subject’s market area are all conducive to irrigated agricultural uses including permanent plantings.



**Financially Feasible** – Irrigated cropland in the area typically generates annual cash rents that range from \$300 to \$600-per-acre, with some market rents surpassing \$1,000-per-acre for high value crops such as strawberries and sweet potatoes. Permanent plantings like almonds and walnuts are typically rented on 6% to 30% crop-share agreements (tenants pay for orchard and water development at the low end of the rates, while owners pay for orchard and water development at the high end of the rates, and taxes, insurance and management fees are negotiable), which tend to net the owner greater than \$600-per-acre at maturity but are more risky than flat-rate rental agreements. The income generated by irrigated cropland exceeds typical expenses and produces a positive net return to the land. It is noted that irrigated cropland, when farmed in conjunction with a dairy, or heifer feedlot facility, contributes greater financial feasibility than the typical annual cash rent for irrigated cropland, as dairy facilities typically rent for \$12 to \$20 per milk cow per month, while heifer lots typically rent for \$3 to \$5-per-head-per-month. This income exceeds typical expenses and produces a positive net return.

**Maximally Productive** – The subject's physical characteristics and positive net income indicate that the maximally productive use as if vacant would be for commercial agricultural purposes, specifically as irrigated cropland suitable for a variety of uses. The individual needs of potential buyers would dictate which use would be most feasible, as there are several.



## AS IMPROVED

**Legally Permissible** – the subject property is and has been historically utilized for agricultural purposes; specifically, and primarily as a dairy production unit with complementing irrigated field/row cropland.

Current agricultural use as a dairy facility is legally permissible and conforming to the County AG 40-acre minimum parcel size zoning regulation. Although, the estimated capacity stated in this report may be considered legally conforming, the appraisers are not qualified to make an exact determination. As of the date of the appraisal the dairy operation was operating under a grand fathered status.

The subject facility would only lose this grand fathered status if it remained vacant for more than one-year, at which point the subject facility can compliantly be operated as a dairy replacement heifer feedlot as an alternative. According to a County official, for a dairy facility to legally operate again, it would be required to go through the process of obtaining a conditional use permit, which would likely trigger the requirement to complete an Environmental Impact Report. However, the appraiser has taken this feedlot scenario into consideration, its impact on the value of the subject property, and will discuss the findings.



Physically Possible – The current use is physically possible as viewed within the entire operation as demonstrated by the subject property and abundance of similarly utilized properties in the area.

Financially Feasible – Financial feasibility is deemed supported by the continued marketability and rental arrangements for dairy properties, correlated with a willingness of buyers, sellers and tenants within the market to accept income generated by these agricultural properties. An analysis of the subject's financial feasibility is demonstrated as follows:



**HBU Analysis:**

**SCA**

**As Conventional Dairy:**

	Ac./MC/SF/LF	Value/Unit		
Land	143.43	\$30,000	\$4,302,900	
Dairy Facility	759	\$700	\$531,300	
<b>Total</b>			<b>\$4,834,200</b>	
Overall Per Ac. Value			\$33,704	

**Income (tenant operated)**

**As Conventional Dairy (per existing lease):**

	# / Units	Rent / Unit	Frequency	Total
Net Cropland	121.00	\$500	1	\$60,500
Milk Cows	759.00	\$18	12	\$163,944
<b>Total</b>				<b>\$224,444</b>

**As Heifer Feedlot:**

Land	143.43	\$30,000	\$4,302,900
Heifer Facility	2,501	\$200	\$500,200
<b>Total</b>			<b>\$4,803,100</b>
Per Ac.			\$33,487

**As Heifer Feedlot (imputed):**

	# / Units	Rent / Unit	Frequency	Total
Net Cropland	121.00	\$500	1	\$60,500
Two Tenant SFR	2.00	\$1,200	12	\$28,800
Heifers	1,250.00	\$5	12	\$75,000
<b>Total</b>				<b>\$164,300</b>

**As IFC available for P.P. and Living Units:**

Land	143.43	\$32,000	\$4,589,760
Owner SFR	3,276	\$85	\$278,460
Tenant SFR'S (3)	3,799	\$40	\$151,960
S. Hay Barn	2,850	\$3	\$8,550
Commodity Barn	1,804	\$5	\$9,020
Building Sub-total:			\$447,990
Dairy clean up			(\$200,000)
<b>Total</b>			<b>\$4,837,750</b>
Per Ac.			\$33,729

**As Mature Almonds and Living Units (imputed):**

	# / Units	\$ / Unit	Frequency	lbs. / Ac.	Share %	Total
Mature Almonds	135.50	\$2.00	n/a	2200	25%	\$149,050
Two Tenant SFR	3.00	\$1,200	12	n/a	n/a	\$43,200
Main SFR	1.00	\$1,800	12	n/a	n/a	\$21,600
<i>(*Have to potentially spend nearly \$1,500,000 to develop)</i>						<b>\$213,850</b>



<u>Land Sales</u>					
Date	Dec-19	May-20	Dec-18	Jun-20	Oct-19
Acres	236.47	19.70	20.03	29.42	167.35
Land \$/AC.	<b>\$34,000</b>	<b>\$31,000</b>	<b>\$30,955</b>	<b>\$30,000</b>	<b>\$18,400</b>

<u>Dairy Sales</u>						
Date	Dec-19	Jan-20	Nov-18	Jul-18	Jun-18	Jun-20
No. MC	450	450	400	600	560	500
\$/MC	<b>\$800</b>	<b>\$983</b>	<b>\$658</b>	<b>\$725</b>	<b>\$532</b>	<b>\$711</b>
No. LF	1,300	1,620	1,408	1,785	1,826	1,930
\$/LF	<b>\$277</b>	<b>\$273</b>	<b>\$187</b>	<b>\$243</b>	<b>\$163</b>	<b>\$184</b>

- Whether a dairy facility (current use), as a heifer feedlot, or cropland reclaimed for permanent plantings, the difference in total value of the subject property is nominal based on the sales comparison approach.
- Underlying Land: is valued at \$30,000-per-acre, which would remain consistent as a dairy or feedlot, but could potentially increase to \$32,000-per-acre as available for permanent plantings. However, the cost to demolish and reclaim roughly 14½ acres of the facility and site would offset the increase in value, effectively making the land value equivalent as a dairy or feedlot use.
- Building Improvements: As a dairy facility, feedlot, or irrigated cropland available for permanent plantings with farmstead improvements, there is only a \$83,310 difference between the three uses.



- Income Earning Potential: Clearly, the subject's current use as a dairy facility yields the highest gross income due to its current lease agreement. As a feedlot, the facility rent includes the main dwelling and one tenant dwelling for an employee, but still falls short compared to the dairy facility.
- It is recognized that viewing the subject as an established mature almond orchard is a proposed scenario but was included to demonstrate the financial feasibility of the subject's dairy facility, and the utility it continues to offer in the current market.
- Furthermore, similar dairy facilities within subject's marketplace remain in demand as either rental, or satellite facilities as currently operated. Therefore, the subject is valued accordingly as a dairy facility rather than a heifer feedlot, or open land.

Based the scenarios, the subject's current use as a dairy facility not only provides greater financial feasibility, but less risk in comparison to development as an almond orchard, which involves greater expense to the landlord.



Maximally Productive – The property is considered improved and the dairy facility use with irrigated cropland is considered to provide maximum productivity to the property as improved. There are not readily recognized alternate and available uses which would currently provide a higher return as improved. Therefore, the improved highest and best use of the subject property is its current use as a dairy facility operated in conjunction with all available land.

Therefore, the current highest and best use of the subject property, as improved, is concluded to be the existing agricultural use as a dairy facility with supporting land used for irrigated row / field crops.

**H&B Use Conclusion:** Although the property, as vacant, is better suited for use as irrigated cropland available for permanent planting development, the determined highest and best use of the subject property overall is concluded to be the existing agricultural use as a dairy facility, especially considering the cost and difficulty involved in obtaining the required permits to construct a new facility. The option for development to permanent plantings at a future date remains available if the highest and best use of the subject property is no longer determined to be a dairy facility.

# QUESTIONS?

