The Highest & Best Use Playbook

Uniform Appraisal Dataset 3.6

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Fannie Mae

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How to use the playbook

- This playbook provides key concepts and illustrative scenarios to help industry participants better understand how the results of the highest and best use (HBU) may affect loan eligibility.
- Each scenario presents a complex highest and best use question based on the specific circumstances of a subject property. While every property has its own unique characteristics and circumstances, which may lead to different conclusions, these scenarios are designed to demonstrate how you can apply Fannie Mae policy consistently across a range of situations. They are intended to provide practical guidance and support informed, policy-compliant decision-making.
- A resolution is provided for each scenario, along with the appraiser and lender responsibilities with relevant Fannie Mae Selling Guide Supplement: Uniform Appraisal Data (UAD) 3.6 Policy resources.
- The Highest and Best Use Frequently Asked Questions document addresses common questions related to present use, highest and best use, mixed-use properties, analysis of subordinate uses, comparable sales, the URAR, and loan eligibility. The document is available separately and linked throughout the Playbook for easy reference.

Part 1: policy fundamentals

UAD 3.6

Applies to UAD 3.6 appraisal assignments only

Highest and best use

A clearer framework for analyzing and reporting property value and eligibility

Highest and Best Use (HBU) analysis:

Required for *every* appraisal assignment to develop an opinion of market value

Background

- **Under the legacy UAD 2.6 forms**, the appraiser reports a single yes or no conclusion as to whether the property's present or proposed use represents its HBU.
- **UAD 3.6 significantly expands this reporting** by requiring the appraiser to evaluate and report the property's present use against each of the four HBU tests individually.
- To align policy with expanded reporting requirements and to clarify appraiser and lender expectations, **we have updated the HBU and related requirements**.

Benefits

- **Clarifies appraisal reporting** and lender review requirements.
- **Establishes consistent expectations** for completing the HBU analysis.
- **Provides greater flexibility** for residential properties affected by evolving land use and housing trends.
- **Supports more informed lending decisions** with greater insights into property-level collateral risk while helping to preserve loan eligibility.

Call to action: This is a fundamental shift in how the HBU analysis is applied in residential mortgage lending to assess property value and eligibility; appraisers and lenders should familiarize themselves with the new requirements and apply them to all UAD 3.6 appraisal assignments immediately.

Highlights of the policy

Gain clarity on the HBU policy

1

"Residential" as the HBU

Modified the requirement so the property's highest and best use, as improved or as proposed, must be a residential use.

2

New definitions

Defined "present use," "residential use," and "subordinate use" in the context of HBU. See following page for details.

3

"Residential in nature" replaced

Established new requirements specifying the property must be a primarily residential one- to four-unit residence, with a subordinate non-residential use, replacing the "residential in nature" guidance.

4

Eligibility requirements

Defined the property requirements and reporting expectations under which a primarily residential one- to four-unit property may remain eligible if one of the HBU tests is "No."

Definitions and key concepts

A framework for understanding property use and eligibility

Present use*

The **present use** is the most reasonable and probable utilization of a property, as improved, as of the effective date, based on its physical characteristics, design, and functional utility.

Note: Present use reflects how the property is designed and intended to be used, which may differ from how it is currently occupied or utilized by the occupant(s).

Residential use

To qualify as a **residential use**, the property must be primarily built as a residential dwelling, and the market must recognize the residential use as the HBU of the property.

Properties whose HBU is commercial, agricultural, industrial, or otherwise non-residential are not eligible under the subordinate use requirement.

Subordinate use

To qualify as a **subordinate use**, the non-residential use must be secondary to the property's residential use and the property's highest and best use must remain residential.

*For proposed construction, present use is based on the property as proposed to be improved, including the planned design, improvements, and intended use, rather than the property in its unimproved or existing condition.

The four test of HBU

The manner or purpose for which the real property is utilized, or could reasonably be utilized

Legally permissible

A use that complies with applicable zoning, deed restrictions, and other regulatory requirements

Physically possible

A use that is suitable for the site's size, shape, access, and topography

Financially feasible

A use that is economically viable

Maximally productive

A use that results in the highest property value

Different types of uses

The uses shown are illustrative and not intended to represent all possible uses

Residential*
Single-family homes, townhomes, duplexes, multifamily buildings, manufactured housing, condominiums

Commercial
Retail, restaurants, offices, hotels, personal services, shopping centers

Industrial
Manufacturing, fabrication, warehousing, distribution, processing, heavy industry

Agricultural
Farming, ranching, crop production, livestock, orchards, agricultural support uses

Institutional/Public/Civic
Schools, government buildings, hospitals, libraries, religious institutions, utilities, public facilities

Recreational
Parks, golf courses, recreation facilities, conservation areas, greenbelts

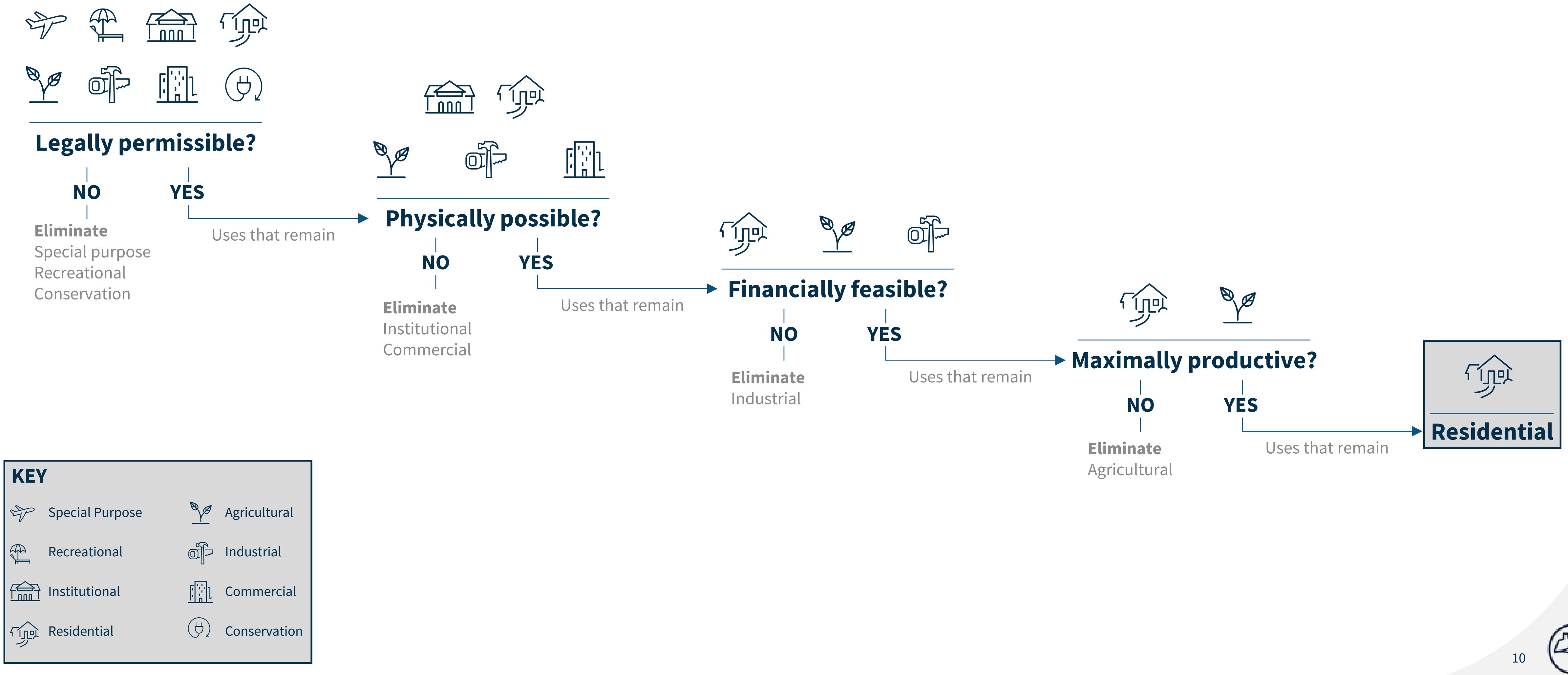
Conservation/Environmental
Wetlands, floodplains, habitat areas, environmentally sensitive land, resource-protection areas

Special Purpose
Airports, military installations, ports, utilities, extraction/mining, transportation facilities, historic districts, and other uses requiring specialized regulation

*For a loan to be eligible for sale to Fannie Mae, the property must be primarily built as a residential dwelling, and the market must recognize the residential use as the HBU of the property. Any non-residential use must be subordinate to the property's residential use.

Narrowing the range of viable uses

Utilizing the four tests can eliminate specific uses; only uses that satisfy all four tests can be considered the HBU



Purpose of HBU analysis

A property’s highest and best use influences what the market is willing to pay for it

Highest and best use

Answers the question, “What reasonable use of this property would result in its highest value?”

- In theory, buyers pay more for properties that reflect their HBU and less for properties that do not, because those properties do not align with market expectations.
- The appraiser estimates market value based on its highest and best use by selecting comparable properties with the same highest and best use and similar physical and legal characteristics.

“As-is” market value

Answers the question, “What would a typical buyer pay for the property today?”

- Regardless of whether a residential property is built to its HBU, Fannie Mae requires the property to be valued as improved (or as proposed) and for that value to account for any functional and external obsolescence when the improvements are not ideal.
- For most residential mortgage appraisals, this analysis is straightforward because the HBU is typically the property’s present residential use as improved. The analysis becomes more important when a property's value potential includes an alternative use that materially affect its value.

Understanding a property’s highest and best use (or lack thereof) helps the appraiser develop an accurate opinion of market value.

Why the HBU analysis is important…

…to the appraiser?

- It considers factors such as zoning, site characteristics, market demand, and economic conditions to assess whether the market recognizes and will pay for untapped potential.
- It allows the appraiser to look beyond the property's present use and physical characteristics to determine whether other factors are driving value.
- If the property's present use is not its highest and best use, the property's value and marketability may be impaired.
- It enables the appraiser to identify the most appropriate comparable sales and properly account for any obsolescence, resulting in a more accurate opinion of market value.

…to the lender?

- It helps the lender understand the factors driving a property's value and marketability.
- It supports eligibility decisions and improves property-level insight for collateral risk management.
- It helps prevent loans secured by land-only or non-residential properties from being delivered to Fannie Mae.

Important: know the difference

Same underlying question, phrased two ways in the Uniform Residential Appraisal Report (URAR):

Is the **present use** of the subject property…

- Legally Permissible
- Physically Possible
- Financially Feasible
- Maximally Productive

Is the highest and best use of the subject property as improved (or as proposed per plans and specifications) the **present use**?"

- These conclusions are based on the tests as applied to the present use and may differ from the HBU conclusion.
- In all cases, if the present use does not satisfy one or more of the tests, the response to the question, "Is the HBU of the subject property as improved (or as proposed per plans and specifications) the present use?" must be "No."

A different question, not asked in the URAR, but equally as important:

Is the highest and best use of the subject property **residential**?"

- Even when the improvement(s) exhibit physical, functional, or external obsolescence, the highest and best use can still be residential.
- This question must be answered in the **HBU Commentary** subsection when the response to the question, "Is the highest and best use of the subject property as improved (or as proposed per plans and specifications) the present use?" is "No."

If "yes," the property may be eligible.
See slide 14

If "no," the property is not eligible.
See Scenario 4 and Scenario 7.

When an HBU test results in "no"

Is the present use…	URAR test result	Is the property eligibility?
Legally permissible?	**No**	**Eligible only if** the illegal use pertains to an accessory dwelling unit (ADU) and the *Zoning for an ADU* requirements in policy topic SB4-1.3-05 are met.
Physically possible?	**No**	**Not eligible** under any circumstance.
Financially feasible?	**No**	**Eligible if** it meets the *Property Requirements* in policy topic SB2-3-01.
Maximally productive?	**No**	**Eligible if** it meets the *Property Requirements* in policy topic SB2-3-01.

If the property is eligible, **the appraiser must** appraise the property as improved (or as proposed) and account for and support any resulting obsolescence in the applicable approaches to value, including the use of comparable sales that reflect similar obsolescence or underlying land potential.

Part 2: real-world scenarios

Eligible

Illegal ADU

HBU classification (as improved): residential

Scenario

The subject property is a one-unit residence with an illegal accessory dwelling unit. The ADU is not allowed under the applicable zoning requirements under any circumstances.

Present use of the subject property

Legally permissible	Physically possible	Financially feasible	Maximally productive
No	Yes	Yes	Yes

*The HBU of subject property as improved is **NOT** the present use.*

Related policies:

- See **Zoning for an ADU** in **SB4-1.3-05,** *Dwelling Exterior, Unit Interior, and Outbuilding Sections of the Appraisal Report*

Appraiser responsibilities

- ❑ Complete the appraisal "as-is" based on the property's present illegal use.
- ❑ State within the appraisal report that the improvements represent a use that does not comply with zoning ("illegal" use).
- ❑ Confirm the illegal use conforms to the subject market.
- ❑ Consider the external obsolescence, along with other applicable forms of depreciation, in each developed approach to value, and adjust comparable sales to reflect market-supported differences.
- ❑ Support the conclusion that the improvements are typical for the market by analyzing at least three comparable sales, of which at least two must include ADUs with the same noncompliant zoning use as the subject property. See FAQ 11 and 27.

Lender responsibilities

- ❑ Confirm the requirements in *Zoning for an ADU* in policy topic SB4-1.3-05 have been met.
- ❑ Confirm property eligibility requirements have been met in *Property Requirements* in policy topic SB2-3-01.

Eligible

Two-units combined

HBU classification (as improved): residential

Scenario

The two-unit residential property has been combined into a single residence by removing the separation of living areas and kitchens. The resulting one-unit dwelling is unusually large and functionally awkward compared with the typical one-unit homes for this market.

Present use of the subject property

Legally permissible	Physically possible	Financially feasible	Maximally productive
Yes	Yes	No	No

*The HBU of subject property as improved is **NOT** the present use.*

Related policies:

- *See Unique Housing Types in* **SB4-1.3-05**, *Dwelling Exterior, Unit Interior, and Outbuilding Sections of the Appraisal Report (12/10/2025)*
- *See* **Property Requirements** in **SB2-3-01,** *General Property Eligibility*

Appraiser responsibilities

- ❑ Complete the appraisal "as is," based on the property improved as a one-unit residence. See FAQ Q7.
- ❑ Provide similar comparable sales. See FAQ 11.
- ❑ Consider the functional obsolescence, along with other applicable forms of depreciation, in each developed approach to value, and adjust comparable sales to reflect market-supported differences.

Lender responsibilities

- ❑ Confirm property eligibility requirements have been met in *Property Requirements* in policy topic SB2-3-01.

Eligible

Commercial zoning

HBU classification (as improved): residential

Scenario

The subject site is zoned for commercial use (allows residential use) and is currently improved with a one-unit residential dwelling. The property is situated on a one-acre corner lot, supporting commercial development. However, current market conditions do not indicate strong demand for commercial use, and surrounding properties remain residential. Based on the appraiser's analysis, the value of the commercial site, if vacant, does not exceed the value of the property as improved with the residential dwelling. This indicates that the existing residential improvements contribute to the property's value and the highest and best use of the property, as improved, is residential.

Present use of the subject property

Legally permissible	Physically possible	Financially feasible	Maximally productive
Yes	Yes	Yes	Yes

The HBU of subject property as improved ***IS*** *the present use.*

Related policies:

- *See* **Property Requirements** in **SB2-3-01,** *General Property Eligibility*

Appraiser responsibilities

- ❑ Complete the appraisal "as is," based on the property as improved as a one-unit residence. See FAQ 7.
- ❑ Provide similar comparable sales. See FAQ 11.
- ❑ Consider the external obsolescence, along with other applicable forms of depreciation, in each developed approach to value, and adjust comparable sales to reflect market-supported differences.

Lender responsibilities

- ❑ Confirm property eligibility requirements have been met in *Property Requirements* in policy topic SB2-3-01.

Not eligible

Commercial zoning

HBU classification (as improved): commercial

Scenario

The subject site is zoned for commercial use (allows residential use) and is currently improved with a one-unit residential dwelling. The property is situated on a one-acre corner lot, supporting commercial development. Current market conditions indicate a strong demand for commercial use, and surrounding properties are being redeveloped for commercial purposes. Based on the appraiser's analysis, the value of the commercial site, if vacant, exceeds the value of the property as improved with the residential dwelling. This indicates the existing residential improvements no longer contribute to the property's value and the highest and best use of the property, as improved, is commercial.

Present use of the subject property

Legally permissible	Physically possible	Financially feasible	Maximally productive
Yes	Yes	No	No

*The HBU of subject property as improved is **NOT** the present use.*

Related policies

- *See* **Property Requirements** in **SB2-3-01,** *General Property Eligibility*

Appraiser responsibilities

- ❑ When the highest and best use (HBU) as improved (or as proposed) is determined to be non-residential, the Uniform Residential Appraisal Report (URAR) is not an appropriate appraisal reporting form. The appraiser should work with the lender on any next steps. See FAQ 8 and 14.

Lender responsibilities

- ❑ Confirm the property does not meet the *Property Requirements* in policy topic SB2-3-01.
- ❑ Do not deliver the loan to Fannie Mae.

Eligible

Subordinate non-residential use

HBU classification (as improved): residential

Scenario

The appraiser observes that the subject property is currently used for both residential and agricultural purposes. The appraiser determines that both uses are legally permissible, physically possible, and financially feasible. However, based on the appraiser's analysis, the residential use results in a higher property value than the agricultural use and is therefore maximally productive. The appraiser concludes that the highest and best use of the property, as improved, is residential, with a subordinate agricultural use.

Present use of the subject property

Legally permissible	Physically possible	Financially feasible	Maximally productive
Yes	Yes	Yes	Yes

*The HBU of subject property as improved **IS** the present use.*

Related policies:

- See **Appraisal Requirements** in **SB4-1.4-07,** *Appraisal Requirements for Mixed-Use Properties*
- See **Mixed-Use Properties** in **SB2-3-04**, *Special Property Eligibility Considerations*
- See **Property Requirements** in **SB2-3-01,** *General Property Eligibility*

Appraiser responsibilities

- ❑ Provide a detailed description of the non-residential characteristics.
- ❑ Indicate that the mixed-use of the property is a legal, permissible use under local zoning requirements.
- ❑ Report any adverse impact on marketability and market resistance to the non-residential use of the property.
- ❑ Demonstrate the improvements are typical for the market through an analysis of similar comparable sales with a subordinate agricultural use.
- ❑ Report the market value of the real property only, and exclude any value attributed to the business use. See FAQ 10 and 20.

Lender responsibilities

- ❑ Confirm the requirements in *Appraisal Requirements for Mixed-Use Properties* in policy topic SB4-1.4-07 have been met. See FAQ 18.
- ❑ Confirm the requirements in *Mixed-Use Properties* in policy topic SB2-3-04 have been met. See FAQ 25.
- ❑ Confirm property eligibility requirements have been met in *Property Requirements* in policy topic SB2-3-01.

Subordinate non-residential use

Eligible

HBU classification (as improved): residential

Scenario

The appraiser observes that the subject property has a mixed-use. The site has no zoning and is adjacent to a community airstrip. The improvements consist of a traditional one-unit dwelling with an attached oversized garage designed to accommodate a small aircraft. The garage includes front and rear doors that provide direct access to the airstrip. The owner uses the aircraft seasonally for crop dusting on nearby agricultural properties. Although industrial use is permissible, the subject property's primary use is residential. The predominant use of surrounding properties with similar aircraft storage is also residential. The appraiser determines the subject property's highest and best use is residential as improved, with a possible subordinate industrial use.

Present use of the subject property

Legally permissible	Physically possible	Financially feasible	Maximally productive
Yes	Yes	Yes	Yes

*The HBU of subject property as improved **IS** the present use.*

Related policies:

- See **Appraisal Requirements** in **SB4-1.4-07,** *Appraisal Requirements for Mixed-Use Properties*
- See **Mixed-Use Properties** in **SB2-3-04**, *Special Property Eligibility Considerations*
- See **Property Requirements** in **SB2-3-01,** *General Property Eligibility*

Appraiser responsibilities

- ❑ Provide a detailed description of the non-residential characteristics.
- ❑ Indicate that the mixed-use of the property is a legal, permissible use under local zoning requirements.
- ❑ Report any adverse impact on marketability and market resistance to the non-residential use of the property.
- ❑ Demonstrate the improvements are typical for the market through an analysis of comparable sales with a similar aircraft hangar.
- ❑ Report the market value of the real property only, and exclude any value attributed to the business use. See FAQ 10 and 20.

Lender responsibilities

- ❑ Confirm the requirements in *Appraisal Requirements for Mixed-Use Properties* in policy topic SB4-1.4-07 have been met. See FAQ 18.
- ❑ Confirm the requirements in *Mixed-Use Properties* in policy topic SB2-3-04 have been met. See FAQ 25.
- ❑ Confirm property eligibility requirements have been met in *Property Requirements* in policy topic SB2-3-01.

Not eligible

Non-subordinate non-residential use

HBU classification (as improved): industrial

Scenario

The subject property is adjacent to a community airstrip and is zoned industrial. The improvements consist of a large, open-span airplane hangar designed to accommodate and service multiple aircrafts. A small residential unit with basic amenities is located at the rear of the structure. While a residential use is allowed, the primary use of this property is for industrial aircraft.

Present use of the subject property

Legally permissible	Physically possible	Financially feasible	Maximally productive
Yes	Yes	Yes	No

*The HBU of subject property as improved is **NOT** the present use.*

Related policies

- See **Appraisal Considerations** in **SB4-1.4-07,** *Appraisal Requirements for Mixed-Use Properties*

Appraiser responsibilities

- ❑ When the HBU as improved (or as proposed) is determined to be non-residential, the URAR is not an appropriate appraisal reporting form. The appraiser should work with the lender on any next steps. See FAQ 8 and 14.

Lender responsibilities

- ❑ Confirm the property does not meet the *Property Requirements* in policy topic SB2-3-01.
- ❑ Do not deliver the loan to Fannie Mae.

Eligible

Upzoning

HBU classification (as improved): residential

Scenario

A property has recently been upzoned to allow development of up to six residential units on one parcel. The site is prime for redevelopment. The subject's present use is a one-unit residence in livable condition and highest and best use is residential.

Present use of the subject property

Legally permissible	Physically possible	Financially feasible	Maximally productive
Yes	Yes	No	No

The HBU of subject property as improved is NOT the present use.

Related policies:

- *See* **Property Requirements** in **SB2-3-01,** *General Property Eligibility*

Appraiser responsibilities

- ❑ Complete the appraisal "as is," based on the property as improved as a one-unit residence. See FAQ 7.
- ❑ Provide comparable sales of similar one-unit residential properties that are zoned to allow up to six units and are similarly positioned for redevelopment. See FAQ 11.
- ❑ Consider the external obsolescence, along with other applicable forms of depreciation, in each developed approach to value, and adjust comparable sales to reflect market-supported differences.

Lender responsibilities

- ❑ Confirm property eligibility requirements have been met in *Property Requirements* in policy topic SB2-3-01.

Eligible

Multiple parcels

HBU classification (as improved): residential

Scenario

The subject includes a second buildable parcel within a fully built-out subdivision. The appraiser determines that the second parcel is not necessary to support the existing improvements and can be sold separately.

Present use of the subject property

Legally permissible	Physically possible	Financially feasible	Maximally productive
Yes	Yes	Yes	No

*The HBU of subject property as improved is **NOT** the present use.*

Related policies:

- *See* **Multiple Parcels** in **SB2-3-04,** *Special Property Eligibility Considerations*
- *See* **Property Requirements** in **SB2-3-01,** *General Property Eligibility*

Appraiser responsibilities

- ❑ Confirm the parcels are adjoined to one another
- ❑ Confirm each parcel has the same basic zoning
- ❑ Complete the appraisal "as is," including both parcels.
- ❑ Account for any loss or gain in value attributable to the inclusion of additional parcels.
- ❑ Provide similar comparables with multiple parcels. See FAQ 11.

Lender responsibilities

- ❑ Confirm the requirements in *Multiple Parcels* in policy topic SB2-3-04 have been met.
- ❑ Confirm property eligibility requirements have been met in *Property Requirements* in policy topic SB2-3-01.

Eligible

Single subdividable parcel

HBU classification (as improved): residential

Scenario

The subject parcel is more than twice the size of a typical single-family parcel in a fully built-out subdivision. The appraiser determines that a portion of the site has the potential to be subdivided to create two separate residential parcels for individual sale.

The potential for subdivision does not, by itself, change the highest and best use of the property, which remains residential. The subject site may have greater value than neighboring sites; however, the single parcel is maximally productive the residential use.

Present use of the subject property

Legally permissible	Physically possible	Financially feasible	Maximally productive
Yes	Yes	Yes	Yes

The HBU of subject property as improved ***IS*** *the present use.*

Related policies:

- *See* **Property Requirements** in **SB2-3-01,** *General Property Eligibility*

Appraiser responsibilities

- ❑ Complete the appraisal “as is,” based on the property as improved as a one-parcel with excess land.
- ❑ Account for any loss or gain in value attributable to the property remaining as a single parcel with excess land.
- ❑ Provide comparable sales of properties consisting of a single parcel with excess land. See FAQ 11.

Lender responsibilities

- ❑ Confirm property eligibility requirements have been met in *Property Requirements* in policy topic SB2-3-01.