

A Comparison of Rental Rates Charged for Downtown Commercial Space

A Market Snapshot of Wisconsin Communities

July-August 2019



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Executive Summary

Rent charged for commercial space is one of the largest expenses of small, independent downtown businesses. This pilot report provides a preliminary analysis of rents paid or advertised for a selection of downtown properties around Wisconsin during the months of July and August 2019. The report is based on two sources of rent data: a survey of downtown business operators (primary research) and an analysis of retail space availability listed on the web (secondary research).

Findings:

- annual rental rates varied significantly from roughly \$10 to \$20 per square foot
- Downtown rents throughout the state were generally 10% to 20% higher per square foot than those in surrounding business districts
- Downtown properties are typically smaller than those in surrounding business districts and represent a different product than a newly constructed retail store at the edge of town that is car dependent
- Unimproved buildings have a lower rent per square foot per year. Improved buildings generated approximately \$3 more per square foot per year. The limited sample size might be hiding the true variation among improved and unimproved buildings
- Places with higher household incomes tend to have higher median commercial rents
- Among smaller cities, population does not seem to be correlated with rental rates as they might be in larger metropolitan areas like Milwaukee or Chicago, where retail demand is greater
- The building condition had a significant impact on rental rates, median household income had little correlation with rental rates, while population size seemed to have no correlation with rental rates
- The amount spent by tenants for rent was approximately 8-percent of sales according to the sample data in the survey. The rent percentage will be lower for restaurant operations that have high production costs, while the rent percentage will be higher for professional services. The 8-percent is a reflection of the tenants surveyed in the study
- Leases observed in the survey sample were mainly described as triple net (defined in the report)
- Survey respondents reported lower rental rates than the online commercial listings

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Introduction

Rent charged for commercial space is one of the largest expenses of small, independent businesses. These businesses often pay 5 to 10-percent of gross revenue for rent.¹ While many lease agreements are based on a fixed dollar amount per month, others might be based on a percentage of sales, or a combination of fixed and variable charges. Nevertheless, given the tight margins inherent in many small downtown businesses, it is critical that businesses closely examine what they pay for rent, adjusting for other operating costs to ensure the rent is fair and competitive in the market.

The University of Wisconsin-Madison/Extension Division and the Wisconsin Economic Development Corporation's Downtown Development Program have studied the rent charged for downtown street front commercial properties that are, or could accommodate retail, restaurants or services. The results of this pilot study are based on a relatively small sample of businesses and should be used as a snapshot of the current (summer of 2019) commercial real estate market in smaller Wisconsin cities.

This study is based on nearly 275 records of occupied - or on the market - downtown commercial spaces throughout the state. This is a small sample of total commercial space, accordingly we call it a pilot. The most urban areas of Wisconsin, Milwaukee, Madison, and Green Bay, were not analyzed due to differences in their markets compared to the rest of the state. Therefore, this analysis is more representative of the smaller municipalities in the state.

The findings in this study provide a useful resource for both renters and landlords to help them make informed decisions based on information collected from tenants and property owners across Wisconsin. It provides useful data on downtown rental rates by city, region, type of tenant, and condition of buildings. Recognizing the lower than expected response rate, the study still provides broad estimates of sales per square foot and rent-to-sales ratio from downtown businesses.

DEFINITIONS

COMMERCIAL SPACE – at least 50 percent of floor space is used for commercial activities such as retail, services, or food service.

RENT – a tenant's regular payment to a landlord for the use of property or land

BASE RENT –the minimum due each month, with extra payments based on the lease agreement

LEASE – a contract by which one party conveys land, property, services, etc. to another for a specified time, usually in return for a periodic payment

MEDIAN - the median is the value separating the higher half from the lower half of a data sample

¹ <http://www.bizstats.com/reports/rent-sales-ratio.php>

Data Sources

The focus of this study was on street-level commercial space suitable for retail, eating and drinking places, and service businesses. Less focus was placed on other uses, such as first floor residential, second floor office space, manufacturing, and other uses that may not be compatible with retail.

Secondary Data

Readily available data from economic development databases were presented on a fixed cost per square foot, from two sources: Locate In-Wisconsin and LOOPNET. These sources represent online databases that showcase commercial and industrial properties for lease or purchase. Locate In-Wisconsin was developed and is maintained by the Wisconsin Economic Development Corporation.

Primary Data - Downtown Business Operator Online Survey

An online survey was conducted in July and August 2019, reporting lease costs as a fixed amount per month. This anonymous survey was to examine the rental rates paid by downtown business operators across Wisconsin. It also attempted to obtain revenue per square foot from these Wisconsin businesses.

Survey responses were kept confidential. Survey participants were informed that they would receive an advance copy of the study in return for completing the survey. Survey weaknesses: data bias and a lower than expected response rate. Additionally, responses we did receive may not accurately reflect the mix of businesses and services that are typically found in our downtowns.

Types of Leases

The following are basic structures describing what the tenant must pay each month in addition to rent:

Single Net Lease: tenant pays utilities and property tax; landlord pays maintenance and insurance.

Net-Net, or Double Net Leases: tenant is responsible for only utilities, property taxes and insurance premiums for the building; landlord pays maintenance.

Triple Net Leases: tenant responsible for all costs of the building, with exception to structural repairs which are generally covered by the landlord. Most landlords of retail space will pass along their costs of maintaining a building as part of a Triple Net Lease. Three common charges are often added to a monthly base rent.

1. CAM (common area maintenance) which is the landlord's cost of shared building services.
2. Cost of insurance premium
3. Cost of property taxes.²

Key Assumptions

The rents reported in the secondary data sources did not consistently identify their type of lease. For purposes of this study, it is assumed that these leases are triple net. It should also be noted that the data used here represents a snapshot in time: July and August 2019. Secondly, it only reflects those commercial spaces that were actively on the market at that time.

² Source: <https://www.thebalancesmb.com/what-it-costs-to-rent-a-building-space-2890493>

City Median Household Income and Downtown Rental Rates

The following chart shows the relationship between city median household income and rental rates for retail, restaurants and services.

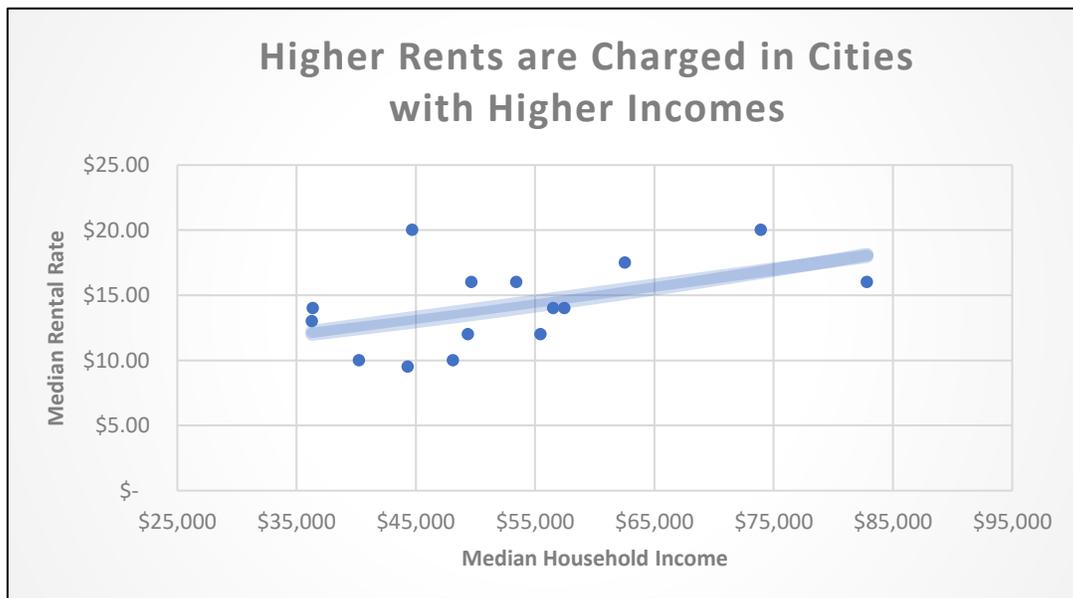
Data was only used for cities that had three or more properties listed in one of the two secondary data sources (Loopnet and In-Wisconsin). The chart describes the median household income compared to the estimated median rent to determine if there is a relationship between community wealth and downtown commercial property rental rates. See table to the right and the graph below.

Findings:

- Based on the trendline included in the scatter dot graphic below, there appears to be an upward trend. This suggests that areas with higher household income often charge higher rental rates.
- Although the sample size of cities and the sample size of properties are low, there appears to be significant variation among the cities. They ranged from \$10.00 per square foot in Stevens Point to \$20.00 per square foot in Sheboygan and Menomonee Falls.

Cities with Three or More Properties Listed	Median Household Income-City	Median Rent Per Square Foot per year
Appleton	\$53,439	\$16.00
Beloit	\$36,384	\$14.00
Delafield	\$82,826	\$16.00
Eau Claire	\$55,480	\$12.00
Fond du Lac	\$48,129	\$10.00
Hudson	\$62,554	\$17.50
Janesville	\$49,372	\$12.00
La Crosse	\$56,552	\$14.00
Lake Geneva	\$49,688	\$16.00
Menomonee Falls	\$73,936	\$20.00
New Richmond	\$57,473	\$14.00
Sheboygan	\$44,710	\$20.00
Stevens Point	\$44,333	\$10.00
Wausau	\$40,260	\$10.00
Wisconsin Rapids	\$36,299	\$13.00

Source: In-Wisconsin and Loopnet



City Population and Downtown Rental Rates

The following chart shows the relationship between city population and rental rates for retail, restaurants and services.

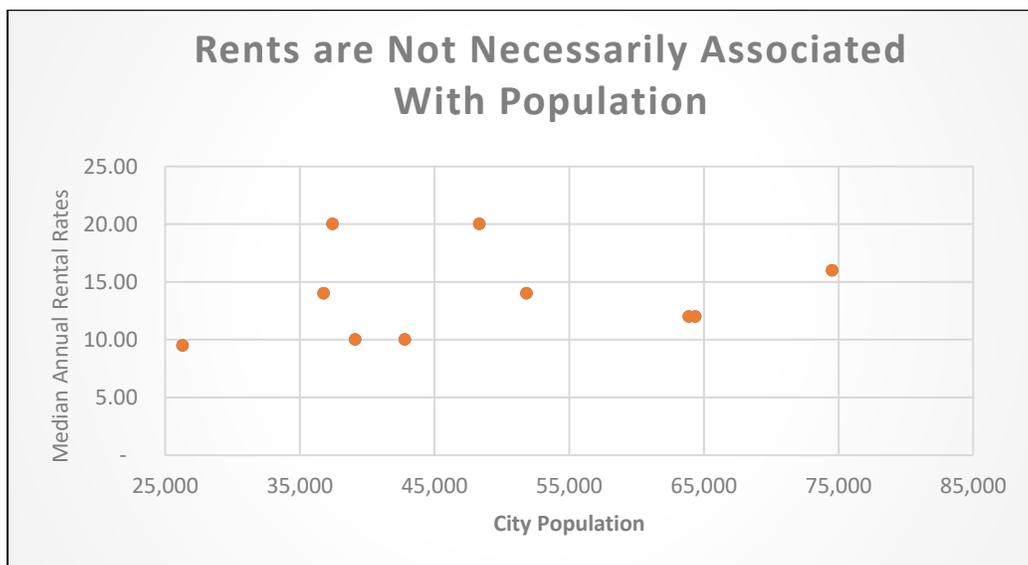
Data was only used for cities that had three or more properties listed in one of the two secondary data sources (Loopnet and In-Wisconsin). The chart presents each city's population in relation to the estimated median rent to determine the relationship between community size and downtown commercial property rental rates. See table to the right and the graph below.

Findings:

- The size of the sampled communities provides no association with rental rates. As previously noted, this observation may be skewed due to the limited number of cities in the sample.
- To compare rental rates with more urban areas across the state, we researched commercial properties in downtown Madison and Milwaukee. In Downtown Madison, the median rent is \$22.00 per square foot. In Milwaukee, the median rent is \$17.00 per square foot. It is plausible that the state's largest cities command a premium in rental rates, especially depending on their location within the city.

Cities with Three or More Properties Listed	City Population	Median Rent Per Square Foot per year
Appleton	74,526	\$16.00
Beloit	36,773	\$14.00
Delafield	7,526	\$16.00
Eau Claire	63,902	\$12.00
Fond du Lac	42,809	\$10.00
Hudson	12,719	\$18.00
Janesville	64,359	\$12.00
La Crosse	51,834	\$14.00
Lake Geneva	7,875	\$16.00
Menomonee Falls	37,443	\$20.00
New Richmond	8,966	\$14.00
Sheboygan	48,329	\$20.00
Stevens Point	26,293	\$9.50
Wausau	39,114	\$10.00
Wisconsin Rapids	17,806	\$13.00

Source: In-Wisconsin, Loopnet, and Survey results



Downtown vs. Other Business District Rental Rates

This analysis provides a snapshot of property for rent during the summer of 2019. It does not represent, year-round availability. It also indicates certain differences in the size of downtown buildings compared to surrounding business districts where square footage tends to be larger.

Region	Downtown Sample Size	Surrounding Business Districts Sample Size	Median Square Feet Downtown	Median Square Feet Surrounding Business Districts	Rent Per Square Foot Downtown. Per Year \$	Rent Per Square Foot Surrounding Business Districts \$
Northwest	33	12	3,050	7,790	14.00	10.00
Northeast	13	18	3,000	5,188	13.00	11.00
Central	38	19	2,450	7,594	12.00	10.00
Southwest	31	18	1,600	3,600	12.00	12.00
Southeast	83	76	2,309	4,650	13.00	12.00
WI Sample	198	143	2,482	5,764	12.00	11.00

Source: Downtown data was from In-Wisconsin, Loopnet, and the survey. Surrounding Business Districts data was sourced from In-Wisconsin and Loopnet. The online survey was sent to downtown business owners and operators through Main Street, Connect Communities, downtown professionals, Chamber of Commerce executives, University Extension educators, the Wisconsin Downtown Action Council board of directors, and others who were asked to forward the questionnaire to building owners and business operators in the state.

Findings:

- Most of the listings and survey responses came from businesses located downtown.
- Downtown rents, throughout the state, were generally 10 to 20- percent higher per square foot than edge of town locations. Downtowns in the sample charged as much as \$1 to \$3 per square foot more than non-downtown properties.
- Downtown properties were smaller than those in surrounding business districts properties primarily because of the smaller building footprints downtown.

The Effect of Building Conditions on Rental Rates

Building condition is related to rent per square foot. In the online survey, participants were asked to identify the condition of their building as either

Improved: renovated or built within the past 10 years

Semi-Improved: some updates to utilities and space

Unimproved: limited recent property improvements.

Results of the survey are presented below.

Condition	Sample Size	Median Square Feet	Rent Per Square Foot per year \$	Median Rent Per Year \$
Improved	44	1,650	11.00	17,400
Semi-Improved	37	1,050	8.00	9,300
Unimproved	17	1,250	8.00	9,750

Source: survey

Findings:

- As expected, unimproved buildings have a lower rent per square foot per year, reflecting their ability to attract a more price sensitive client. Rent ranged from \$8.00 to \$11.00 per square foot per year.
- Almost half of the properties in the sample were reported as “improved.” This rating may vary among a wide spectrum of improvements, from very little work done to significant historic rehabilitation.



Rent to Sales Percentage

According to Austin Tenant Advisors, of Texas, there is a benchmark that is increasingly used by decision makers called the rent to sales (revenue) ratio. According to the firm, this is also known as the occupancy cost percentage. Simple to calculate, the base rent to sales helps a potential business decide if a location makes economic sense to rent. The ratio typically varies from 2% to 20% depending on the type of business you are in. A retailer should target a base rental rate that is no more than 5% to 10% of gross annual sales, but a law firm may find a rent to revenue ratio of 15% acceptable.³

Usable WI Sample Size	Median Square Feet	Median \$ Rent Per Square Foot per Year	Rent per Year	Median \$ Sales Per Year	Revenue per Sq. Ft.	Rent to Sales Percent
39	1,200	8.30	10,000	185,000	\$154	8.0%

Source: Survey

Findings:

- Based on the results of the survey, existing businesses indicated that they generate over \$12 in revenue for each dollar spent on rent.
- This is equivalent to a rent expense of 8-percent of sales. This includes a diverse mixture of businesses that operate with varying industry norms for rent expense percentage.
- The high rent expense, as a percentage, might be a reflection of the sample which included many professional services, but very few food and beverage operations.

CALCULATE YOUR RENT TO SALES PERCENT or OCCUPANCY COST PERCENT:

Total Annual Rent Payments \$ _____



Total Annual Sales \$ _____



Rent to Sales % _____%

COMPARE WITH YOUR PEER BUSINESSES:

Th rent to sales ratio will vary from 2% to 20% depending on the type of business you are in. Retailers should target a base rental rate that is no more than 5% to 10% of gross annual sales, but a law firm may find a rent to revenue of 15% acceptable

³ <https://www.austintenantadvisors.com/blog/what-should-your-annual-rent-to-annual-sales-ratio-be-when-leasing-commercial-real-estate/>

Appendix A: Choosing a Location and Building

When choosing a location for your business, you might consider these factors:

- Local market - what are the consumer demographics and lifestyle choices in the area?
- Tourists and seasonal traffic – are tourists a part of your targeted market?
- Steady car and foot traffic – traffic generators often include universities, hospitals, and local attractions
- Storefront visibility and accessibility – are you centered in the heart of downtown?
- Distance from major metropolitan area – Consumer demographics may differ
- Business Mix – is there an appropriate balance of competition?

When choosing a building, you might consider:

- The building condition- are there historical preservation and renovation opportunities?
- Zoning restrictions – what may prevent you from renovating?
- Water accessibility and potential damage – position of water movement can cause major unforeseen problems (e.g. hill vs. swampy area)
- Adequate parking and sidewalks – how accessible is your location?
- Other tenants – what other retailers or activities might disrupt your business?
- Accessibility, visibility, signage – will the storefront make a positive first impression?

Appendix B: Negotiate Your Rent

Landlords often expect prospective tenants to negotiate a lease, but few take advantage of this opportunity. In Wisconsin, many downtown businesses do not have a formal written lease. Many tenants find that commercial lease negotiations take too much time, and do not properly read the terms before signing. However, taking the time to read the fine print and negotiating and writing clauses could save the tenant thousands of dollars, and create a thriving business. A copy of a standardized lease can be obtained here: https://www.wra.org/Resources/Transactional/Residential_Rental_Resources/

What to watch out for:

- The Common Area Maintenance Fee (CAM) and other vague fees - Know what these fees cover.
- The Escalation clause - Landlords can increase the base rent if maintenance fees increase.
- The Rubber Ruler technique - Are you paying for the same square feet as advertised?
- Oral agreements - Make sure the oral agreements are also included in the written document
- Triple net leases – These are often in favor of the landlord, so watch out for extra expenses

What to consider including in the lease:

- Competitor clause - You can require the landlord to refuse leasing to a competitor
- Co-tenancy clause - If a major competitor arrives, or another business creates problems for you.
- First right of refusal – this clause gives you the opportunity to renew your lease before your landlord offers a lease to a new tenant. In addition, it can be written so that you have the right to purchase a property if the owners decide to sell.

What you can negotiate:

- Improvements – if there is any damage or need for renovation, negotiate with the landlord.
- Common Area Maintenance fees – if other tenants use building amenities more than you
- Perks (Free Wi-fi, parking, etc.)
- Ask about inducements – your landlord wants to rent to you just as much as you want to rent.
- Determine your rent budget based on sales revenue or expected gross margin, operating expenses, taxes, and other sources of income

Other Suggestions:

- Ask for a copy of all utility bills for the space
- Take a picture of any damage present before occupancy
- Ask tenants and local realtors about the reputation of the landlord
- Research the reputation of the tenants.
- Determine if the business mix of the building aligns with your business objectives
- Negotiate two or more locations at the same time so it's easier to walk away from a negotiation
- Research market rent trends and compare with the landlord's asking rent
- Get a copy of the initial lease in writing so you can write a counter offer
- Have a good relationship with your landlord, but don't let yourself be taken advantage of.

Source: see references that follow

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