



# Downtown Idea Exchange

Essential Information for Downtown Revitalization

May 2010

## *Perspectives*

### **As we leave the recession, affordable downtown retail rents are a revitalization imperative**

By N. David Milder

As we slowly emerge from the Great Recession, the time has come for downtown organizations to work hard on encouraging small independent retailers to seek affordable rents, and for landlords to offer them. If they do not, downtown retail will contract, and street-level storefronts will be occupied even more by financial and personal service operations, or remain vacant for long periods of time.

True, in many downtowns retail rents have declined during the recession, often substantially. In one I recently visited, for example, asking retail rents have dropped from \$45/sq. ft. to \$30/sq. ft. and in some instances even \$25/sq. ft. But, as we creep out of recessionary conditions, it is critical that in most downtowns retail rents do not regain their unaffordable levels.

In the new normal, small downtown retailers will be facing increased pressures to keep their operations lean and mean, because capturing sales from today's deliberate consumers is far more difficult than from the abnormally free-spending shoppers of the 1990s and 2000s. One budget line item they can focus on is the cost of the spaces they lease for their stores. This is a major long-term business

expense and it is important that these retailers do not pay more than they can afford. It is also a business cost where newbie retailers dominate those going astray, though badly inept or unscrupulous merchants also tend to pay a lot more than what savvy merchants would deem affordable.

Looking at the other side of the coin, it is also in the interest of landlords to offer rents competent retailers can afford.

In the new normal, far fewer stores will be opened by national chains and, among those, a smaller percentage than in the past will be placed in downtowns. Landlords, as a result, will need many local independent retailers to fill their storefronts. This will also be true to a significant degree for those who have built new mixed-use buildings with expensively constructed ground floor storefronts. Additionally, as their rents reach ranges considered unaffordable by savvy merchants, the more likely they are to attract incompetent or sleazy businesses and to have storefronts stand vacant for long periods of time.

**Defining affordable retail rents.** A useful formulation for determining an affordable retail rent is roughly 15 percent of the shop's annual sales. DANTH's merchant surveys and

***"It is in the interest of landlords to offer rents competent retailers can afford."***

This article was reprinted from the May 2010 issue of *Downtown Idea Exchange*.

Interested readers may subscribe to the monthly newsletter by visiting <http://www.downtowndevelopment.com> or phoning (973) 265-2300.

© 2010 Alexander Communications Group, Inc. All rights reserved.

No part of this article may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying or otherwise without the prior written permission of Alexander Communications Group.

personal interviews with merchants over many, many years as well as the work of other firms, such as Urbanomics, found that downtown merchants generally felt that they could afford total rent costs that were eight to 12 percent of their annual sales. However, more recently merchants say they are OK

with 15 percent. While there is certainly some error factor present here, 15 percent is probably plus or minus just a few percentage points off the correct number. The major thrust of the analysis presented here is not affected by this error factor.

In a typical medium-sized downtown, independent retailers with annual sales of \$500,000 to \$1 million are relatively rare. Most independent downtown retailers would be quite happy with sales in the \$300,000 range and joyous with sales around \$450,000. Though in large downtowns the sales-happiness range can be higher, the 15 percent rule applies everywhere, so I'll stick with the retailers in medium-sized downtowns to simplify my argument.

The table on page three depicts information about:

- How much rent is affordable to retailers with \$250,000, \$300,000, \$350,000, \$400,000 and \$450,000 in annual sales. You can do the calculations for higher annual sales.
- How many square feet of space this rent money can buy at various prices per square foot.

The table also shows how with increased rents more and more of a downtown's most successful merchants cannot afford to occupy the amount of space they might even minimally need for their operations. Look at how quickly even small spaces in the 1,500 sq. ft. to 2,000 sq. ft. range become unaffordable. At \$40/sq. ft. not even a retailer with sales of \$450,000 can afford a 2,000

### Affordable Retail Rents

Annual retail sales	\$250,000	\$300,000	\$350,000	\$400,000	\$450,000
Affordable rent percentage	High of 15%	High of 15%	High of 15%	High of 15%	High of 15%
Maximum affordable rent in \$	\$37,500	\$45,000	\$52,500	\$60,000	\$67,500
Affordable SF at:					
\$10/SF	3,750	4,500	5,250	6,000	6,750
\$20/SF	1,875	2,250	2,625	3,000	3,375
\$30/SF	1,250	1,500	1,750	2,000	2,250
\$40/SF	938	1,125	1,313	1,500	1,688
\$50/SF	750	900	1,050	1,200	1,350
\$60/SF	625	750	875	1,000	1,125

To remain affordable in the typical downtown, retail rents should be capped at 15 percent of annual sales.

sq. ft. space; at \$50/sq. ft. even a 1,500 sq. ft. storefront becomes out of reach. Of course, for the \$300,000 shopkeeper, that happened at lower rents: a 1,500 sq. ft. shop is unaffordable at rents of \$31/sq. ft. and 2,000 sq. ft. at \$22.50.

Affordable rents should be tied in with balloon leases, where rents increase at an agreed-upon rate (say, 15 percent) as the retailer's sales grow. Some savvy downtown landlords are already using balloon leases, where rent is contingent on sales and the landlords have access to the books of their tenants. While low-cost rent is needed to bring new independent retailers into spaces, once they gain traction and start making money, they can afford to pay a more substantial rent.

**To all the groaners.** To the downtown managers and Main Street managers who groan that it is impossible to deal with landlords:

- Dealing with downtown landlords and dealing with them effectively is part of your job. If you are not doing it, start doing it. If you do not know how, learn how. If after all that you still can't deal effectively with landlords, get another job.
- Every occupation has jerks; but they also often have a lot of reasonable, effective, and even innovative people. This applies to landlords, too.
- Find the landlords you can work with to implement an affordable rents program, and then use them as a model to recruit others.

- One thing is certain: If you do not try, nothing will happen.

**To landlords and developers who groan** that they need high incomes from their new and expensively constructed retail spaces to pay off their loans:

- You are big boys and girls, and you like to brag about that, so man and woman up.

- You either goofed in your calculations or you really did not understand that in most downtown mixed-use projects outside of places like Manhattan and downtown Chicago, etc., the residential and office rents, probably for some time, will have to subsidize the retail spaces. This is especially true of unproven, revitalizing downtown locations.

- Given the current economic conditions, your options are really either affordable rents that will diminish your losses or long-term vacancies and continued lack of retail rental revenues.

**To landlords who believe they should get market-rate rents** as defined by the highest asking rents they've heard about in the district:

- Your unaffordable rents are likely to produce vacancies, because so few accomplished retailers would be interested, and/or perpetual churn, because you are likely to attract inept or schlocky merchants who are prone to failing or disappearing.

- This will affect the resale value of your property — and this is not a great time for any commercial property.

- Have you really calculated the difference between the income that an affordable rent will yield and the zero dollars you will likely reap from the months your stores stay vacant because you want higher rents?

*N. David Milder is president of the downtown consulting firm DANTH Inc. Email him at [danthinc@yahoo.com](mailto:danthinc@yahoo.com). **DIX***