

Affordable Space

How Rising Commercial Rents Are Threatening Independent Businesses, and What Cities Are Doing About It



Executive Summary

The cost of leasing commercial space is soaring in many U.S. cities, threatening the future of independent businesses. In cities as diverse as Oakland and Nashville, Milwaukee and Portland, Maine, retail rents have shot up by double-digit percentages over the last year alone. As the cost of space rises, urban neighborhoods that have long provided the kind of dense and varied environment in which entrepreneurs thrive are becoming increasingly inhospitable to them.

Local businesses that have been serving the everyday needs of their communities, sometimes for generations, are being forced out and replaced by national chains that can negotiate better rents or afford to subsidize a high-visibility location. In ILSR's 2016 *Independent Business Survey*, 59 percent of independent retailers reported being worried about the escalating cost of rent, with one in four describing it as a top challenge. The trend isn't limited to retailers. The price of industrial space is rising rapidly too, jeopardizing a budding renaissance in urban manufacturing.

This report examines what's causing commercial rents to skyrocket and explores six broad policy strategies that elected officials and community leaders are proposing to address it.

We find that the sharp rise in rents isn't limited to affluent neighborhoods. It's happening across a range of communities, with some of the most intense pressure falling on businesses in lower income neighborhoods. The problem is especially detrimental to people looking to start new businesses, further raising barriers to entrepreneurship and stunting economic dynamism.

Just as there's a public stake in the availability of affordable housing, so too is there a public interest in the commercial side of the built environment. Having a healthy independent business sector is closely tied to other municipal policy priorities, including reducing climate emissions, expanding jobs, lessening economic inequality, and strengthening the social fabric of neighborhoods.

A complex web of causes lies behind rapidly growing and increasingly unaffordable commercial rents:

- **Soaring commercial real estate prices** – A global surplus of capital seeking higher returns is flooding into urban commercial real estate, causing a speculative run-up in prices.
- **The increasing popularity of cities** – Cities are booming as more people seek walkable, mixed-use urban districts. While this has increased opportunities for businesses, it's also driven up demand for small storefront space, with the rise in rents often significantly outpacing sales growth.
- **The growth imperative of national chains** – Increased demand is also coming from national chains, which, having saturated the suburbs and under pressure from shareholders to show square footage growth year after year, have turned to cities to sustain their expansion.

- **A limited and declining supply of small spaces** – Older urban buildings are being redeveloped or razed, and the projects that replace them often provide spaces that are designed for chains and too large to be suitable or affordable for local entrepreneurs.
- **A preference for national companies over independent businesses in commercial real estate financing** – Banks and other lenders often provide lower interest rates or better terms if a property owner or developer has signed national, brand-name tenants.

This report outlines a range of ideas that elected officials, business owners, and community leaders have come up with for keeping space affordable and ensuring that entrepreneurs continue to thrive:

1. Broaden Ownership

Although not suitable for every small business, owning rather than leasing is one of the best ways to ensure stable occupancy costs. Only a small minority of independent retailers currently own their space. Several cities are exploring programs to increase that share by helping businesses buy their buildings, or buy their spaces as commercial condominiums. Another approach involves expanding community ownership of commercial buildings. Through various structures, such as real estate investment cooperatives, neighbors can invest in commercial buildings and guarantee local businesses long-term stability and reasonable, cost-driven rent increases.

2. Reduce the Power Imbalance in Landlord-Tenant Negotiations

Another set of policy ideas would give small businesses certain rights when it comes time to renew their leases. These protections might include an established timeline for negotiations, an option for a long-term lease, and recourse to arbitration. Cities are also looking at ways to provide property tax credits to landlords who provide affordable leases to locally owned businesses.

3. Zone for a Local Business Environment

Zoning can be a powerful tool for creating a built environment that provides plenty of opportunity for local entrepreneurs. Key strategies include protecting the varied fabric of established commercial districts, ensuring an ample supply of small spaces, and adopting business diversity ordinances that encourage a mix of different types of businesses.

4. Set Aside Space for Local Businesses in New Development

Several cities have required that a portion of the space in select new development projects be set aside for locally owned businesses. These requirements could be codified and applied across all development projects that meet certain size or location thresholds.

5. Create a Preference for Local Businesses in Publicly Owned Buildings

Cities often own and invest in real estate themselves. Some are establishing a preference for leasing spaces in city-owned or -financed buildings to locally owned businesses. In underserved communities, this could include offering space at below-market rates to local, neighborhood-serving businesses.

6. Recognize Businesses as Cultural Landmarks

Following in the footsteps of Rome, Paris, and London, San Francisco has established a program to recognize and support longstanding, culturally significant businesses. The program provides incentives to landlords who agree to 10-year leases, and it could also evolve to help businesses purchase their spaces.

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