



# Office Market Issues and Takeaways

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Horizon Commercial Appraisal

# Overview

- Construction feasibility and cost vs. value
- Poorly designed office facilities



# Construction Costs Traditional Office

Class D Average Quality Office	10,000 square feet @	\$94.64 /square foot =	\$946,400
Total Base Cost			\$946,400
Floor Area Perimeter Multiplier			1.000
Story Height Multiplier			1.000
Plus Sprinkler System (Average)	10,000 square feet @	\$3.60 /square foot =	\$36,000
Current Cost Multiplier			1.020
Local Cost Multiplier (Wisconsin Average)			1.060
<b>Total Hard Costs</b>		=	<b>\$1,062,171</b>
Plus Soft Costs		5% =	\$53,109
<b>Total Replacement Cost New</b>		=	<b>\$1,115,279</b>
Plus Entrepreneurial Incentive		0% =	\$0
<b>Total Development Cost</b>		=	<b>\$1,115,279</b>
Added Site Cost (0.20 FAR, 50,000 SF site, \$5.00/SF)			\$250,000
Added Site Improvements Cost			\$75,000
<b>Total Construction Cost</b>		=	<b>\$1,440,279</b>
<b>Rounded To</b>		=	<b>\$1,440,000</b>
<b>Per SF</b>		=	<b>\$144.00</b>

# Construction Costs

## Medical Office

Class D Average Quality Medical Office	10,000 square feet @	\$121.61 /square foot =	\$1,216,100
<b>Total Base Cost</b>			<b>\$1,216,100</b>
Floor Area Perimeter Multiplier			1.000
Story Height Multiplier			1.000
Plus Sprinkler System (Average)	10,000 square feet @	\$3.60 /square foot =	\$36,000
Current Cost Multiplier			1.020
Local Cost Multiplier (Wisconsin Average)			1.060
<b>Total Hard Costs</b>		=	<b>\$1,353,771</b>
Plus Soft Costs		5% =	\$67,689
<b>Total Replacement Cost New</b>		=	<b>\$1,421,459</b>
Plus Entrepreneurial Incentive		0% =	\$0
<b>Total Development Cost</b>		=	<b>\$1,421,459</b>
Added Site Cost (0.20 FAR, 50,000 SF site, \$5.00/SF)			\$250,000
Added Site Improvements Cost			\$75,000
<b>Total Construction Cost</b>		=	<b>\$1,746,459</b>
<b>Rounded To</b>		=	<b>\$1,745,000</b>
<b>Per SF</b>		=	<b>\$174.50</b>

# Feasibility Rent

<b>Traditional Office</b>			
	<b>Low</b>	<b>Average</b>	<b>High</b>
Construction Cost	\$1,440,000	\$1,440,000	\$1,440,000
<i>Applicable Cap Rate</i>	7.50%	8.00%	8.50%
<b>Required NOI</b>	<b>\$108,000</b>	<b>\$115,200</b>	<b>\$122,400</b>
Replacement Reserves at \$.50/SF	\$5,000	\$5,000	\$5,000
Management at 5% EGI	\$9,632	\$10,011	\$10,389
CAM Charges at \$7.00/SF	\$70,000	\$70,000	\$70,000
<b>Required EGI</b>	<b>\$192,632</b>	<b>\$200,211</b>	<b>\$207,789</b>
Vacancy Allowance at 7%	\$14,499	\$15,070	\$15,640
<b>Required PGI</b>	<b>\$207,131</b>	<b>\$215,280</b>	<b>\$223,430</b>
CAM Charges at \$7.00/SF	\$70,000	\$70,000	\$70,000
<b>Feasibility Rent</b>	<b>\$137,131</b>	<b>\$145,280</b>	<b>\$153,430</b>
<b>Feasibility Rent per SF</b>	<b>\$13.71</b>	<b>\$14.53</b>	<b>\$15.34</b>

Other markets have higher cap rates, slightly lower CAM charges, and slightly higher vacancy in general

Cap rate, CAM charges, and vacancy refer to Milwaukee Metro Market

<b>Medical Office</b>			
	<b>Low</b>	<b>Average</b>	<b>High</b>
Construction Cost	\$1,745,000	\$1,745,000	\$1,745,000
<i>Applicable Cap Rate</i>	7.25%	7.75%	8.25%
<b>Required NOI</b>	<b>\$126,513</b>	<b>\$135,238</b>	<b>\$143,963</b>
Replacement Reserves at \$.50/SF	\$5,000	\$5,000	\$5,000
Management at 5% EGI	\$10,606	\$11,065	\$11,524
CAM Charges at \$7.00/SF	\$70,000	\$70,000	\$70,000
<b>Required EGI</b>	<b>\$212,118</b>	<b>\$221,303</b>	<b>\$230,487</b>
Vacancy Allowance at 7%	\$15,966	\$16,657	\$17,348
<b>Required PGI</b>	<b>\$228,084</b>	<b>\$237,960</b>	<b>\$247,835</b>
CAM Charges at \$7.00/SF	\$70,000	\$70,000	\$70,000
<b>Feasibility Rent</b>	<b>\$158,084</b>	<b>\$167,960</b>	<b>\$177,835</b>
<b>Feasibility Rent per SF</b>	<b>\$15.81</b>	<b>\$16.80</b>	<b>\$17.78</b>

# Current Market Rents - Milwaukee

## Traditional Office Rents

*7280 South 13<sup>th</sup> Street, Oak Creek*



\$12.00/SF, NNN Asking Rent, 10,000 SF

*140 South 1<sup>st</sup> Street*



\$16.00/SF, NNN Asking Rent, 9,162 SF

*-Undisclosed Recently Signed Lease*

\$14.50/SF, NNN, 12,000 SF, Class A/B Office  
Constructed 2008

## Medical Office Rents

*3130 West Rawson Avenue, Franklin*



\$22.00-\$25.00/SF NNN Asking Rent, 8,000 SF

*4655 North Port Washington Road, Glendale*



\$14.50/SF, NNN Asking Rent, 10,708 SF

*-Undisclosed Recently Signed Lease*

\$21.77/SF, NNN, 4,555 SF, Class A Dental Office  
Constructed 2007

# Current Market Rents – Other Areas

	<u>Traditional Office</u>	<u>Medical Office</u>
Milwaukee CoStar Report, Class B Office - \$14.88/SF	<del>\$13.00</del> -\$15.00/SF	\$16.00- <del>\$20.00</del> /SF
Dane County - \$15.75/SF (5.85% higher)	\$13.76- <del>\$15.88</del> /SF	\$16.94- <del>\$21.17</del> /SF
Kenosha County - \$15.34/SF (3.09% higher)	<del>\$13.51</del> -\$15.59/SF	\$16.62- <del>\$20.78</del> /SF
Racine County - \$14.02/SF (5.78% lower)	<del>\$12.25</del> -\$14.13/SF	<del>\$15.08</del> -\$18.84/SF
Outagamie County - \$13.28/SF (10.75% lower)	<del>\$11.60</del> -\$13.39/SF	<del>\$14.28</del> -\$17.85/SF
Green Bay - \$12.40/SF (16.67% lower)	<del>\$10.83</del> -\$12.50/SF	<del>\$13.33</del> -\$16.67/SF
Sheboygan County - \$12.29 (17.41% lower)	<del>\$10.74</del> -\$12.39/SF	<del>\$13.21</del> -\$16.52/SF
<b>Feasibility Rents</b>	<b>\$13.71-\$15.34/SF</b>	<b>\$15.81-\$17.78/SF</b>

In Outagamie County, Green Bay, and Sheboygan County it is not financially feasible to construct new office space.

Only in Sheboygan County is it not feasible to construct medical office space.

# External Obsolescence

	Average Market Rent		Profit/(Ext. Obsolescence)	
	<u>Traditional Office</u>	<u>Medical Office</u>	<u>Office</u>	<u>Medical Office</u>
Milwaukee	\$14.00/SF	\$18.00/SF	(3.65%)	7.14%
Dane County	\$14.82/SF	\$19.05/SF	2.00%	13.39%
Kenosha County	\$14.55/SF	\$18.70/SF	0.14%	11.31%
Racine County	\$13.19/SF	\$16.96/SF	(9.22%)	0.95%
Outagamie County	\$12.50/SF	\$16.07/SF	(13.97%)	(4.35%)
Green Bay	\$11.67/SF	\$15.00/SF	(19.68%)	(10.71%)
Sheboygan County	\$11.56/SF	\$14.87/SF	(20.44%)	(11.49%)
<b>Feasibility Rents</b>	<b>\$14.53/SF</b>	<b>\$16.80/SF</b>		

All of this analysis assumes that the building is single tenant, does not require an elevator or basement, and 100% leasable.

Multi-tenant buildings have higher cap rates, most buildings are 80% to 90% leasable, and many times office buildings have basements and elevators which add to construction cost, but not rent rates.

# Poorly Designed Office Buildings

**Office building in Glendale, Wisconsin**



Constructed 2006

7,754 square feet, two stories, wood frame construction with face brick

Class B interior finishes

5,025 square feet rentable space (64.8% gross building area), with three tenant suites

Underground parking basement with 3,929 SF space

Three stop elevator required due to parking basement

Fully sprinklered with a wet sprinkler system due to parking basement

Not the actual building, but close

# Cost to Construct

Office Building	7,754 square feet @	\$100.01 /square foot =	\$775,478
Underground Parking	3,929 square feet @	\$38.97 /square foot =	\$153,113
<b>Total Base Cost</b>			<b>\$928,591</b>
Floor Area Perimeter Multiplier			1.041
Story Height Multiplier			1.000
Plus Sprinkler System	11,683 square feet @	\$3.81 /square foot =	\$44,512
Plus Elevator			\$52,000
Current Cost Multiplier			1.020
Local Cost Multiplier			1.060
<b>Total Hard Costs</b>		=	<b>\$1,149,505</b>
Plus Soft Costs		5% =	\$57,475
<b>Total Replacement Cost New</b>		=	<b>\$1,206,980</b>
Added Site Value			\$200,000
Added Site Improvements Value			\$40,000
<b>Indicated Market Value via the Cost Approach</b>		=	<b>\$1,446,980</b>
<b>Rounded To</b>		=	<b>\$1,445,000</b>
<b>Per SF</b>		=	<b>\$186.36</b>

Without parking basement, sprinkler system and elevator (required because of parking basement), cost to construct would be \$148.96/SF.

# Feasibility Rent

Building is 64.8% leasable space (5,025 SF of 7,754 SF). Remainder is a common area vestibule, hallways, stairwells, and kitchenette.

CAM charge is \$9.78/SF due to low leasable space ratio, elevator cost, and basement maintenance cost.

<b>Poorly Designed Office</b>	
	<b>Average</b>
Construction Cost	\$1,445,000
<i>Applicable Cap Rate</i>	<i>7.75%</i>
<b>Required NOI</b>	<b>\$111,988</b>
Replacement Reserves at \$.50/SF	\$5,842
Management at 5% EGI	\$8,787
CAM Charges at \$9.78/SF	\$49,122
<b>Required EGI</b>	<b>\$175,738</b>
Vacancy Allowance at 7%	\$13,228
<b>Required PGI</b>	<b>\$188,965</b>
CAM Charges at \$9.78/SF	\$49,122
<b>Feasibility Rent</b>	<b>\$139,843</b>
<b>Feasibility Rent per Leasable SF</b>	<b>\$27.83</b>

Actual contract rents at the time of viewing were \$21.00-\$24.00/SF, Gross (\$11.22-\$14.22/SF, NNN equivalent)

Based on 16.00% physical depreciation (8 yr. age/ 50 yr. life new), external and functional obsolescence combined are around 48%.

# Summary

- New office or medical office construction is not financially feasible in many areas of Wisconsin
- The Madison and Kenosha markets appear to be the most healthy for new office and medical office construction
- Construction cost rarely equals value in today's market
- External obsolescence is typically present even in newly constructed, ideally designed, leased office buildings
- Properties with owner specific design elements such as parking basements, large vestibules, substantial common areas, and unnecessary elevators for the size of the building can see substantially higher external and functional obsolescence upon construction.
- Some developers continue to build office properties for long term gains or due to lack of other investment options.

