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WALGREENS BILL WILL LEAD TO HIGHER TAXES FOR WISCOSNIN BUSINESSES

With CEO Magazine just naming Wisconsin the 10th best place to conduct business, the State is officially on the national economic development map. While Wisconsin has come a long way over the past several years (ranked 43rd in 2009), there continues to be one glaring weakness in its offerings. Despite all of the progress that has been made to attract and grow business, Wisconsin continues to be a high-tax state. The Tax Foundation recently ranked Wisconsin #39 in the U.S. for total tax burden and the 4th worst state for property taxes.

Legislators are currently discussing changes to the way that real estate will be assessed, specifically targeting commercial properties occupied by job-creating businesses. Labeled Senate Bill - 291, "The Walgreens Bill " (which should not be confused with SB-292, "The Dark Store Bill") the proposed legislation seeks to fundamentally change the assessment of properties leased to a business via a third-party property owner, also known as a triple-net lease in which the **tenant** is responsible for paying the annual real estate tax bill. While the Bill targets large national retailers, specifically Walgreens, the new legislation will potentially have profound impact on property taxes for **all types** of businesses.

Of greatest concern to the commercial real estate industry, is the impact on property taxes for real estate that is held and traded for third party investment purposes. Current assessment law states that "Market Rents" must be used to determine a fair market value for investment real estate. The legislation seeks to codify that an assessor should be able to value a property based upon 1.) its value upon an arms length sale and 2.) **actual** in place rents instead of **market rents**.

"IN PLACE RENT" VERSUS "MARKET RENT"

The real estate investment marketplace is very dynamic, allowing for third-party real estate investors to own and sell properties as holdings that generate income which are leased to tenants that run the spectrum from large national retailers all the way to small tool & die manufacturers. At the heart of the matter is the qualification of "**In Place Rent**" vs. "**Market Rent**". Companies like Walgreens, which typically do not own their real estate, leverage what is called a "build-to-suit" in which all costs of the development are compiled into a total budget and a pre-negotiated market capitalization rate or "cap rate" is applied to derive an "In Place Rent" with the developer/owner. The "In Place Rent" will typically be much higher than what a vacant storefront in the area would lease for.

Where the issue gets even more complicated comes after the developer completes construction of the building and the tenant starts paying rent. The developer can take the security of a long-term lease and sell it in the real estate investment market place as a long-term triple-net leased property.

INCREASE IN PROPERTY TAXES – WALGREENS EXAMPLE

There are significant tax dollars at stake when reviewing the consequences that the legislation could deliver to the business community:

	Market Value	Property Taxes
Walgreens "**Market Rents**" $12.00/SF: (current law)	$2,485,000	$59,565
Walgreens "**In Place Rents**" $19.45/SF: (proposed law – Developer holds)	$3,000,000	$71,910
Walgreens Investment Sale: (proposed law- Developer sells)	$5,600,000	$134,232

Instead of being assessed a market value of $2.485 million based upon "**Market Rents**", if the developer sells the property in the current market, Walgreens could now be assessed the arms length transaction value of $5.6 million with a property tax consequence of more than a 100% annual increase!

SMALL BUSINESSES WILL BE DISPROPORTIONATELY IMPACTED

Walgreens is not the only example of the challenges that "In Place Rents" and " Market Rents" are going to create for many different types of businesses when facing assessments. Manufacturing companies typically have significant infrastructure commitments to a facility and the cost to relocate their machinery can run into the hundreds of thousands of dollars. It is not uncommon for the "In Place" rent that a manufacturer pays to be at a premium to what the "Market Rents" are because the landlord understands the manufacturer is a captive tenant.

The arguments in favor of this proposed legislation have been simplified to focus on a single occupier of real estate, however, this issue is much larger than leased Walgreens stores. In 2016 alone, Real Capital Analytics tracked the total volume of commercial investment property sales in Wisconsin to be worth **$2.208 Billion** dollars and this figure doesn't even include multi-family transactions. Walgreens real estate accounted for only **3.7% of ALL commercial investment sales tracked within the State.** If the "Walgreens Bill" is enacted, **96.3%** of all other Wisconsin businesses that occupy space in a leased property will be faced with much higher property taxes based on factors that are completely out of their control.

Supporters of SB-291 will argue that a large publically traded company like Walgreens has the means and resources to shoulder the higher property tax burden. The Bill fails to consider the thousands of mom-and-pop retail stores and small manufacturers that lease their real estate from a third-party property owner and who will now be facing the prospects of a massive property tax increase should their third-party property owner decide to sell the property in a very strong market for investment real estate.

All businesses in Wisconsin must be very concerned about the long-term impact this legislation will have on their property tax bills. While Governor Walker's pledge to reduce property taxes has been a major win for all Wisconsin businesses, high property taxes continue to be a main cost-impediment to growing and keeping a business in Wisconsin. Let's not jump at a short-term opportunity to capture a few more property tax dollars and jeopardize momentum that favors growing companies so that Wisconsin may become the #1 State for business.

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