FOCUS ON THE ECONOMY

REAL ESTATE & THE FREE MARKET E-CONOMY

by Samuel Zell

Much was made in the early 80s of the advent of the "paperless office" as the personal computer hit the desktops of every office worker in America. Yet while electronic mail has certainly flourished, just as impressive is the exponential increase in the amount of paper crossing the average American office desk. Rather than eliminating paper, the shift has been in the speed and number of channels through which paper can now be disseminated.

So too, it is premature to predict the demise of commercial real estate based on the ability of the consumer to shop at home via the Internet, or the office worker to navigate supply chain negotiations via an Internet site. Bringing the customer in contact with the merchandise, or bringing office workers together for the creative interaction that fuels innovation are as unlikely to go away as paper. The tightest office markets in the country are those with the largest "Internet economies," and the mantra of all customer-facing retailing has become the multi-channel marketing strategy.

But the inroads of the new economy are indeed being felt by the owners – and ultimately the users — of real estate in the new economy. The key word is not necessarily "new" — rather . . . it's "economy." While fundamental changes are underway in how business is being done, as yet the basic laws of economics have not been repealed. Regulatory and legislative bodies are particularly susceptible to jumping on a new bandwagon, but current approaches to regulation of the new economic order risk substantially jeopardizing the very growth they wish to promote.

Such an issue is that of "forced access" for telecommunications providers. These proposals at the federal and state levels seek government-mandated access for some telecom providers that would allow them to install their equipment in private buildings at little or no cost. Under these proposals, a select group of providers could be relieved of any obligation to compensate owners for the use of their private property. With the granting of access by fiat rather than negotiation, the ability of real estate owners to provide services such as cable, fiber-optic wiring, satellite antennas/dishes, and wireless technologies based on customer preference and demand would be substantially compromised. Small- to medium-sized businesses have been historically disadvantaged by lack of choice and service options. It is the intent of real estate owners to protect the value of their investments by seeing their customers receive the best of both.

The economics of modern, large-scale real estate rests in large part in that, just as other capital intensive industries, it competes for customers based on efficient use of resources. Economies of scale and scope have become more and more relevant in the competitive environment as tenants recognize and benefit from operating efficiencies. Professional management has taken on extraordinary significance. The introduction of new technologies into the marketplace are requiring substantial investments, significant R&D, and a great deal of due diligence. Prudent property owners are highly motivated to ensure that a selection of quality providers is available, because today's sophisticated tenant is unlikely to settle for anything less than the most competitive options. Forced building access is not only unnecessary, it is unwise.

Just as damaging as misguided access strategies that favor vendors rather than customers and owners, are taxation strategies that provide preferential tax treatment to one distribution channel over another. National tax policies should promote equal treatment for all commercial transactions regardless of whether sales are made in a store, from a catalog, or via the intranet. Singling out Internet sales for tax exemptions while either maintaining current tax levies or shifting greater tax burdens to in-store retailers clearly significantly shifts economic advantage, towards perhaps unintended ends.

The goal for all such intervention should be towards a competitive landscape, rather than a protectionist one. Engineering of a sales tax disequilibrium is likely to have severe — and unexpected — consequences for local economies and taxing authorities. Existing sales and use taxes provide critical funds for police, fire departments, education, and other essential governmental services. In addition, by providing online retailers a competitive edge over brick-and-mortar retailers, current tax policy confers substantial preferential treatment to a single distribution channel over another that might be equally desirable to consumers.

Regulatory and legislative watchdogs are particularly vulnerable to trying to "solve" the challenges of business in the new economy. But trying to identify where the public good lies is particularly perilous in this new age of driving economic growth. The concept of the "digital divide" is often used as justification of measures that may actually be counterproductive; for example, lower income people may be particularly disadvantaged by limiting their primary access to higher cost distribution channels.

The goal of Washington should still be to maintain a level playing field, where the forces of free-market negotiation and competition will ultimately provide the greatest amount of choice, and spur new investment for greater rewards.

There has been no need to offer tax advantages to modem manufacturers over paper mills to prime the computer business, nor to protect paper producers against the phone companies. The marketplace will regulate, voting with its dollars. REI

ABOUT OUR FEATURED COLUMNIST

Samuel Zell, *Chicago, is chairman of the board of Equity Office Properties Trust, Equity Residential Properties Trust, Manufactured Home Communities Inc., and Capital Trust. He manages the two largest REITs in existence and is a much sought-after contributor and speaker for various real estate-related publications and programs.*