



The Office-Building Model (excerpt)

By Dr. Mason Gaffney

Article citation:

Gaffney, Mason. "The Office-Building Model (excerpt)." November 1989. Study guide.

Fair Use Disclaimer

The Robert Schalkenbach Foundation, a non profit private foundation, is publishing this article, at no cost, pursuant to the Fair Use provisions of Section 107 of the Copyright Act which states that under certain circumstances, the fair use of a copyrighted material for purposes of criticism, comment, teaching, scholarship and research is not an infringement of copyright. If you have any concerns about the publication of this article, please contact us at info@schalkenbach.org.

The Robert Schalkenbach Foundation's Digital Collections and Archives is an extension of the Robert Schalkenbach Foundation's Engel Georgist Library. It collects, organizes, preserves, and provides free online access to researchers and the general public of Georgist literature including books, newspapers, pamphlets, scholarly articles and archival materials.

RSF is particularly proud to offer free online access to the works of the late Georgist scholar Mason Gaffney, made possible through the generosity of the Danica Foundation and with the consent of the Mason and Letitia Gaffney Trust.

Robert Schalkenbach Foundation: <https://schalkenbach.org/>

Engel Georgist Library: <https://www.librarycat.org/lib/EngelGeorgistLibrary>

RSF Digital Collections and Archives: <https://schalkenbach.starter1ua.preservica.com/>

III, G, 12
#22

The Office-building Model

Excerpt from "How to Revive a Dying City." The Henry George Lecture, St. Johns' University, September 1988. Distinguished Papers No. 89F-1, November 1989, Business Research Institute, St. John's University

Why Cities Should be Revived

Some cities and towns may and should be abandoned. Camps and towns around played-out mines are obvious examples. Some small farm towns and hamlets become redundant when roads let customers range farther and patronize the larger or better town. Salvage what you can and move on.

Some would apply the same logic to all cities. Dead cities aren't lost, they say, but are just rebuilt elsewhere. They were cash cows that have been milked dry, meaning their depreciation allowances are reinvested on new frontiers, and the people and vitality move with the capital. That's a clever and important half-truth, but a half-truth is also half wrong. The basic original site stays put, land can't move. A lot of costly social capital, public and private, can't move either.

We have little room left for throwaway cities in this finite world. New natural sites aren't that common. There is only one water-level route west along the Mohawk, only one Hudson Valley with only one mouth, and here this city (New York) has stood for 350 years. We can't really afford to kiss off The Bronx and build a duplicate environment somewhere. We can't rebuild the natural setting at all, and the sunk social capital is too costly: shipping, docks, rails, The New York Thruway, airports, streets, expressways, subways, water lines, power lines, sewer lines, gas lines, phone lines, churches, schools, bridges, tunnels, museums, Halls of Fame, universities, ...

Of course we can replace the Bronx out at the east end of the Long Island Expressway, too, but that means not only duplicating the micro-infrastructure but adding the Expressway, and corresponding trunk lines for all the utilities, and paying the price of commuting in time and fuel and pollution and auto purchases and tires and repairs and paint jobs and insurance and gridlock and traffic casualties. And then ultimately, when we tire of the new suburbs, where do we go next?

Look at The Earth from a lunarcraft photo. There is only so much, and we already have a big portion of the best temperate zone. This is our Promised Land. "Don't blow it," God keeps

telling Israel in the Bible, "Don't think I'm giving you another Promised Land if you can't handle this one." It seems a reasonable attitude. Nor are other nations disposed to give up their crowded slices of this small, scarce Earth for us.

Furthermore these blighted areas have high potential market values. Picture a topographic map of a city where the contour lines represent points not of equal elevation, but equal market value per square foot. On this kind of topo the peaks, the Everests and McKinleys are in the city retail centers, where just one square foot rises to \$2,000 (that's about \$90 millions per acre, and an acre is about 91 yards on a football gridiron). Land just a few miles or blocks away from such dizzying altitudes can hardly be worthless. Harlem is near Park Avenue; Watts is near Beverly Hills; South State Street is very near the Sears Tower. Newark is 15 minutes by train from Manhattan. Newark office rents are \$25/sf per year. That is less, of course, than in Manhattan, but in Riverside, California we are throwing up offices to get rent of \$12/sf per year, while Newark stagnates.

The capital you invest that earns \$25/sf is more productive, obviously, than that yielding \$12. I don't mean the capital in the floor atop the high-rise because that is likely to cost \$25/sf (in annualized terms) to build and operate. I mean the capital in the middle and bottom floors, which cost less to build but rent for as much or more, yielding a surplus. To get more such middles and bottoms, and the corresponding surpluses, renew more land in those neglected areas of high potential like Newark. Not to renew those lands is to waste those potential surpluses. Each year's loss is lost forever, for the services of urban land perish with time.

Shall we treat The Bronx as a residence of last resort for people who can't afford anything decent? That's hardly necessary. To many people cities are The Big Apple, desirable locations of positive values and strong magnetism. Rich foreigners come from around the world and pay top dollar to locate in Manhattan, not because they have to but want to. So it is too with San Francisco, Miami Beach, Beverly Hills, Newport Beach, Cambridge and Georgetown. If they want open country there is plenty left in North Dakota, Texas and Nevada -- but they want cities.

Urban revival works best when a healthy piece remains on which to anchor new development. In the worst scenario no such place remains, but even Camden has Campbell Soup; Newark has a great airport, a new Hartz Mountain Industrial Park, and the Pru.

Life is persistent and resilient; vital seedlings keep sprouting, they only want sunshine, water, care and cultivation.

The Urban Surplus

One of the reasons we remember the early American economist Henry George was his pioneering work on cities, how they work and what good they do. Previous economists showed limited or no understanding of location value and its causes. Even Heinrich von Thünen, father of location theory, approached cities in an arid, antiseptic way that left out most of the sperm and egg, enzyme and ferment that today we call urban linkages and synergy. George was a Mensch, like Holly Whyte or Jane Jacobs, seeing cities in intensely human, interactive terms.

George saw cities as foci of communication, cooperation, socialization and exchange, and these as the basis of civilization. He saw cities as the new frontier, an endless series of new frontiers because the city as a whole enjoys increasing returns: the presence of people with good mutual access, associating on equal terms, expedites cooperation and specialization through the market. Multivariate interactions in cities are synergistic. Indeed, while each part -- each parcel of land -- is developed in the stage of decreasing returns, the composite city is generally in a stage of increasing returns, thanks to synergy: the whole is greater than the sum of its parts, and increases to the whole yield more than the sum of increases to the parts.

This synergistic surplus, says George, lodges in urban land rents. Thus he explained an outstanding phenomenon of his times which other economists were overlooking completely, viz. the unparalleled rise of urban rents and land prices, and the wealth and power of the owners.

To the investor in a building, it looks like this. The first \$10K he spends yields him 30%, or \$3K; but he pays 10% interest, or \$1K, leaving him a surplus of \$2K. To acquire the superior location that confers that surplus he'll pay up to \$2K annually, which means he'll pay up to \$20K for title to the land (at 10%, \$20K will cost him \$2K/year).

Of course the next \$10K he spends may yield him more than 10% too, say 20%, conferring more surplus and adding more value to the land. But the idea is the same. He'll add to the building until the last unit of \$10K yields him just 10%, enough to pay

interest and no more. (You have just taken a flying tour through the theory of diminishing marginal productivity.)

To understand ground rents and land prices is to understand cities; not to understand is to remain mired forever in confusion and fallacy, to be gulled and misled and bamboozled, which is indeed and alas the common lot of mankind. Let it not be yours.

These ground rents are annual; they continue forever; and they generally tend to rise. To buy title to land, therefore, people pay prices that look very high relative to current cash flow. In Riverside, California, a city of low density and 208,000 people, land prices go up to \$18/sf. In San Francisco, a city of high density and 800,000 people, prices go up over \$1,000/sf. In Manhattan they go over \$2,000. In Tokyo, probably the top of the line, one sale is reported at \$25,000/sf. An official agency has appraised the top value at \$120,000/sf, although this may be puffed up.¹ But \$25,000/sf is high enough: urban land prices take your breath away.

Land prices vary extremely from city to city, and block to block. The actual cost of building a square foot of floor space is fairly constant from place to place, but demand varies with location. A small rise of floorspace rentals translates into a large rise of ground rent and land price, because rent gets everything above what is required to operate and amortize the building.

Thus in Riverside in a small neighborhood mall a floorspace rental of \$12 just pays for the building with only a little left over to pay for land, resulting in land prices of perhaps \$5-\$8/sf. In Manhattan rentals are triple or quadruple those in Riverside, with all the surplus going to ground rent, resulting in land prices up to \$2,000/sf, or about 300 times higher than Riverside.

In bigger cities at key locations land prices are not just high per square foot, they are higher per capita than in small cities. Surprisingly, they are even higher relative to building values, in spite of the high-rise buildings. Remember each added

¹The above was written at the height of the Japanese land bubble. Today, 1996, we realize all Japanese land prices were puffed up to levels much higher than could be justified by rents, or long sustained. They were illusions - deadly ones, for many buyers and lenders.

floor until the top one adds more ground rent because floorspace rentals are more than enough to cover the added cost.

Urban land is also highly concentrated in ownership, meaning a handful of people and corporations own most of it. It is heavily favored by absentees of great wealth who want to diversify their holdings and acquire stable, secure wealth they can manage by remote control, so today a growing share of income property is held by aliens. Aliens even hold a good deal of residential property in selected communities of international jet-set ambiance and repute, places like Palm Beach, La Jolla, Atherton, Greenwich, Belvedere or Beverly Hills.

Comparing cities and neighborhoods, land prices are much more differentiated than other measures economists commonly cite, in their traditional blindness to this factor. The median income in upper east side Manhattan is about 8 times higher than north of Central Park. But the price of land psf is probably 40 times higher. Margaret Reid in her classic Housing and Income presents many more contrasts of the same kind; so does Harold Brodsky in his studies of Washington, D.C.