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ONLINE SALES TAX WILL HAVE LITTLE EFFECT ON INDUSTRIAL REAL ESTATE

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A hot-button issue in Washington, DC right now is pending legislation, titled the "Marketplace Fairness Act," which would require online retailers to collect sales tax on goods sold to customers in every state. Currently, laws in most states only require retailers to collect tax if they have a store, office, warehouse or similar operation located within state lines. Customers are expected to individually report sales taxes for goods purchased tax-free on the internet, but this rarely occurs. The National Retail Federation estimates that state and local governments are missing out on roughly $24 billion per year in these unpaid "use taxes". Many online vendors limit their physical operations to a few states in order to maximize the number of customers that will not be required to pay sales tax. This is only one of many advantages that the large online retailers have. Should the legislation as proposed become law, it is unlikely to dramatically change the competitive layout of the marketplace, at least from a commercial real estate perspective.

Proponents of the legislation include local "mom & pop" and other brick-and-mortar retailers, as well as big box stores—these retailers already have physical locations in every state and are required to charge sales tax on online sales—and Amazon, which has changed its public stance on the issue over the past two years. The main pillar of Amazon's support appears to be the expansion of its network of warehouses, as the company chases the holy grail of online retail/same-day delivery in major metropolitan areas. Opponents of the bill include mainly smaller online retailers who may not have the technological or accounting resources to deal with implementing the new tax collection requirements. John Donahoe, CEO of eBay, has been publicly outspoken about the harm this may pose to small online businesses—more than a few of them use the eBay platform.

The reality is that these pending taxation changes are unlikely to change the competitive landscape much. Customers have not been saving enough on taxes for the loss of those savings to shift their shopping behavior toward physical stores. Online retailers will still maintain a convenience factor as well as the pricing advantage associated with not needing to support physical storefronts. As the chart below shows, e-commerce sales have been steadily gaining a larger share of overall retail sales. This trend is likely to continue regardless of the implementation of the proposed sales taxes.

E-Commerce Retail Sales as a Percent of Total Retail Sales

Source: Census.gov.

Other top-tier online retailers in the same league as Amazon should now be considering whether to expand their warehouse networks to reduce shipping time between customers' orders and final delivery. If the barrier to expansion has been a desire to avoid sales taxes, then a mandate to collect it makes the decision to expand significantly more attractive. However, those lacking the resources to build million-square-foot facilities across the country may instead be in the market to lease available space from existing distribution facilities.

From a logistics standpoint, very little is likely to change. Although small online retailers appear to lose the most ground in this fight, they generally do not have the capital resources, nor the demand, to support warehouses across the country, so limiting physical operations to a few states for tax reasons is not a likely part of their expansion strategy, as it may be for larger companies. Rather, they rely on companies such as FedEx and UPS to ship their goods to consumers. These two companies rely on hub models, with major activity focused in select markets across the country. Smaller online merchants have tended to locate their distribution centers closer to these hubs, which route packages all over the country, rather than worrying about locating closer to the end customer. For example, a major FedEx distribution facility in Memphis, Tenn. has attracted a wide array of logistics business to the area, including consumer electronics, flower purveyors, and pharmaceuticals.

The table below shows the expanding square-footage of warehouse space in select hub markets, based on average annual growth rates over the past 10 years. The data show that warehouse stock in these markets has grown, on average, at an annual rate more than 100 basis points above that of the Sum of Markets. Of course, smaller online merchants are not the sole reason for warehouse growth in these hub markets, but competition to get goods from the warehouse to the customer's doorstep will only intensify, and co-locating near major hubs is their best opportunity. We expect this trend to continue, as smaller operators in the online marketplace will continue to rely on the shipping companies to get their products to the consumer.

Warehouse Stock Growth in Hub Markets, Past 10 Years

Distribution Hub Market	Avg Annual Growth Rate
Chicago	1.50%
Columbus	1.44%
Dallas	1.82%
Fort Worth	1.55%
Hartford	0.43%
Indianapolis	2.30%
Memphis	1.17%
Miami	0.72%
Newark	0.25%
Oakland	0.46%
Philadelphia	4.10%
Riverside	1.54%
Average	1.44%
Sum of Markets	0.37%

Source: CBRE EA.

All of this said, the future looks like more of the same for e-commerce companies. If the Marketplace Fairness Act is implemented, online retailers will need to adjust some of their internal practices, but their demand for industrial warehouse space is likely to remain on track. The market will split into two segments: the big players will pursue the Amazon model across state lines and closer to densely populated high-demand areas, while the smaller companies will only worry about getting their inventory near hub markets. Demand for warehouse space will continue to grow in markets that put their goods closest to the customer, whether that is in each local market or simply near a major UPS facility.