

# UCLA ECONOMIC LETTER

## REAL ESTATE AND THE MACROECONOMY

*A partnership between the UCLA Ziman Center for Real Estate and the UCLA Anderson Forecast sponsored by the Ziman Center's UCLA Rosalinde and Arthur Gilbert Program in Real Estate, Finance and Urban Economics*

DECEMBER 2015

Monthly condensed analyses of crucial real estate and economic issues offered by the UCLA Anderson Forecast and UCLA Ziman Center for Real Estate. Here, Paavo Monkkonen, assistant professor of Urban Planning at the UCLA Luskin School of Public Affairs, and Nathan S. Holmes, recent graduate of the urban planning program at the UCLA Luskin School of Public Affairs, suggest how Airbnb can survive opposition.

## Will Airbnb Go the Way of Napster?

*By Paavo Monkkonen and Nathan S. Holmes*

---

For many modern travelers, the best way to see a new city is to find an apartment in a hip residential neighborhood using the short-term home rental company Airbnb. The numbers bear this out: the San Francisco-based company is currently valued at \$24 billion, and every month sees steady growth in the number of hosts and visitors. But lately Airbnb has come face to face with a serious threat: hostility from local governments. Last year, the New York attorney general declared most Airbnb listings illegal in New York City, and officials in Paris conducted raids of illegal Airbnb units. Now some smaller cities are going even further, as evidenced by the Santa Monica City Council's recent ban of all short-term rentals within the city.

*"Airbnb has to work harder to find ways to transition from its current perception as a 'disruptor' to that of a partner."*

As Airbnb looks for ways to address this situation, it would do well to look a few miles northeast of Santa Monica toward Hollywood, where 15 years ago a similar drama played out in the music industry. Napster operated an upstart online platform that created problems for establishment media companies as it matched songs with consumers on the Internet

by cutting out record companies and other traditional gatekeepers. In the end, Napster's success was cause for its downfall — the music industry unleashed an onslaught of litigation that crippled the company so profoundly it is no longer a major player in the music business. The lesson here is that in circumventing the existing system, Napster ignored the possibility of collaboration with existing stakeholders in the industry, and had it chosen another path, things could be very different for the company today.

Airbnb finds itself in much the same place with respect to some city governments. In its rush to corner the home-sharing market, the company risks engendering a serious backlash in certain metropolitan contexts that threatens its business model. Although as yet there is only mixed evidence that Airbnb is either cutting into hotel taxes or pulling a significant number of housing units off the market, cities are understandably concerned about any possibility of lost revenue and the prospect of long-term rental units being taken off the market in neighborhoods where increasing housing supply is unfortunately not possible. Residents of many neighborhoods have their own worries over how a sudden increase in the amount of short-term rental properties affects the character of their neighborhood.

As tempting as it might be for Airbnb to charge ahead on its current path, perception matters, and a good lesson of this can be seen in a company that found success where Napster failed. A few years after the Napster showdown, Steve Jobs and Apple released iTunes, offering record companies a business model that charged for songs on a digital platform. Apple's willingness to work with the music industry led to outstanding profits for the company in the 2000s, and such collaboration continues to infuse its approach to launching new products and services. When pop star Taylor Swift recently upbraided Apple for not compensating artists during a three-month trial period of its new streaming music service, Apple retreated almost instantly. This move says less about Swift's star power and more about Apple's deep concern for how it manages perceptions of fairness, and its sensitivity to all of its stakeholders' needs.

There are many ways that Airbnb could heed these lessons when dealing with city governments and the residents they represent. Most cities operate on limited budgets, and Airbnb could start by paying the same taxes required of hotels. Airbnb could also work more proactively on its end to clamp down on owners that operate their rentals on a quasi-permanent basis throughout the year so that cities aren't required to dip so heavily into their own coffers for policing oversight. More ambitiously, Airbnb can think creatively about spreading its chief benefit of additional tourism spending more broadly, perhaps by experimenting with lower fees for low-income neighborhoods and sponsored marketing programs to encourage tourism in these neighborhoods. Above all, Airbnb has to work harder to find ways to transition from its current perception as a "disruptor" to that of a partner that leverages its innovative platform to enhance cities for all residents, and not just visitors and their hosts in the popular areas.

At a certain point perception becomes reality. As Airbnb contemplates different relationships with cities, they would be wise to heed the example of Apple's success working with established stakeholders. Otherwise the upstart company may find themselves known as the Napster of the short-term rental market.

—

*Paavo Monkkonen is an assistant professor of Urban Planning at the UCLA Luskin School of Public Affairs and a research fellow at the UCLA Ziman Center for Real Estate. Nathan S. Holmes is a recent graduate of the urban planning program at the UCLA Luskin School of Public Affairs.*