



Downtown: The Economic and Fiscal Engine of the District of Columbia

Executive Summary

Downtown plays a central role in Washington, DC's continuing job growth, office development and fiscal resurgence. Downtown's renaissance during the past 10 years has helped transform the city's image and identity into that of a vibrant, thriving and dynamic urban center.

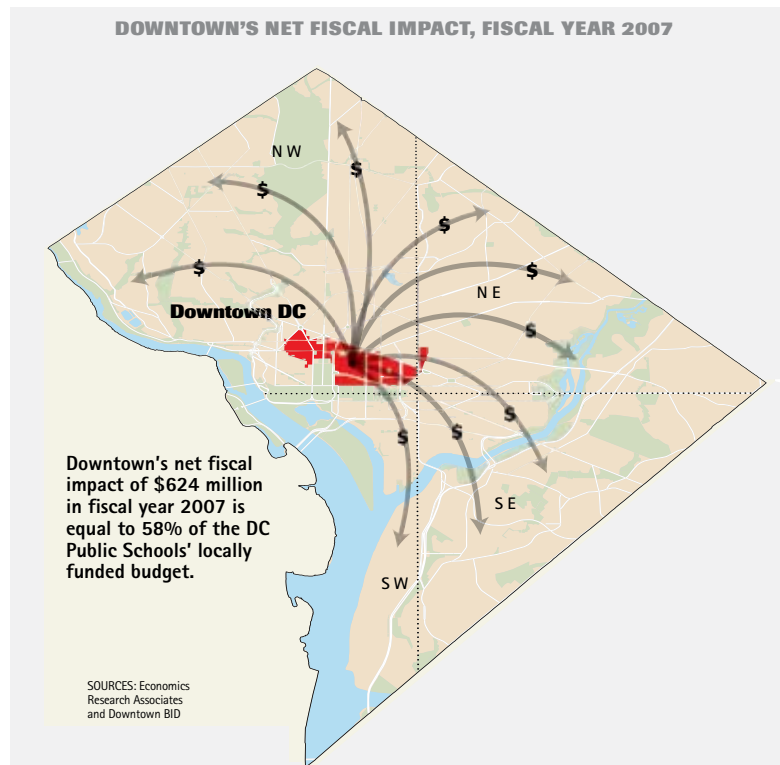
The foundation of this rebirth has been Downtown's job and income growth, which has generated new commercial office development, as well as retail and residential development. In turn, this new development and the resulting substantial increase in real estate values have translated into significantly increased tax revenues to enable the DC government to meet the city's basic needs.

A recent study conducted for the Downtown DC Business Improvement District (BID) showed that recent Downtown job growth has outpaced that of the District of Columbia and the region as a whole. The Downtown BID area alone added approximately 57,000 jobs from 1996 through 2006. Downtown DC added high-value jobs, as well as jobs in the retail and hospitality and leisure sectors that are accessible to all skill levels.

As a result, the Downtown commercial office market has grown, adding 11 million square feet of office space to the city's inventory during the same time period—the same amount of office space that currently exists in Downtown St. Louis.

In another study, the BID found that the Downtown area's net fiscal impact on the District of Columbia government was approximately \$624 million for fiscal 2007, roughly equivalent to 58% of the DC Public Schools' locally funded budget. Much of the net fiscal impact is due to commercial property taxes and deed taxes growing as a result of both new commercial development and a significant increase in commercial property assessments, which almost doubled from 2002 through 3Q 2007.

Downtown's continued economic growth is essential to help meet the DC government's budget projec-



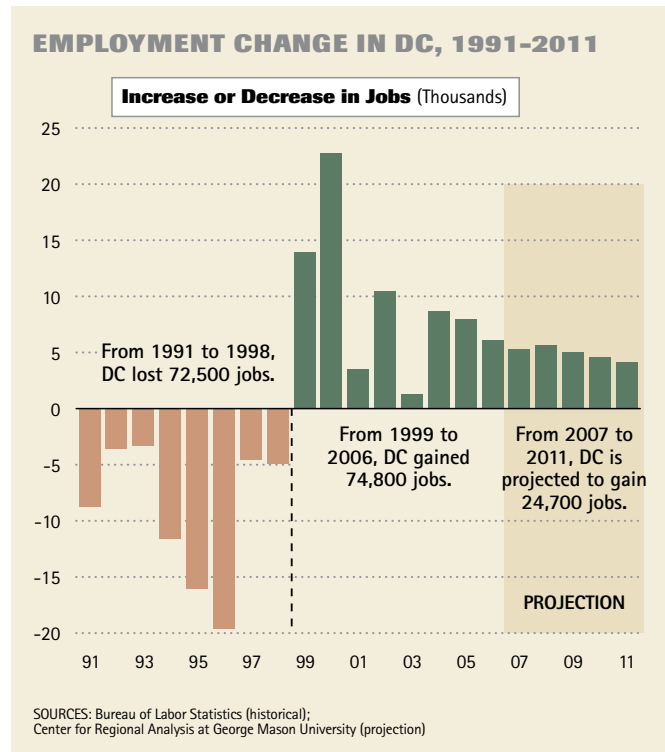
tions of annual revenue growth at 5.6% from fiscal year 2006 through fiscal year 2011. A key challenge for city leaders, inextricably linked to the challenges of improving schools, enhancing public health and producing affordable housing, is to sustain the current economic and fiscal momentum. The challenge is all the more robust because of the need to develop emerging markets in Mount Vernon Triangle, NoMa and the Capitol Riverfront, while competing with neighboring jurisdictions such as Crystal City, Rosslyn and Silver Spring, which have significantly lower office rents and ever improving amenities.

Job Growth

The key indicator for economic development in any city is job growth. To understand the employment picture in Washington better, the Downtown BID commissioned a study that revealed not only the DC economy's dynamic nature, but also Downtown's critical role in this economy.

Key findings of the study, conducted by the Center for Regional Analysis (CRA) at George Mason University, include the following:

- DC added 67,400 net new jobs from 1996 through 3Q 2007, or growth of 10.4%. During this period, DC accounted for 11.7% of the total job growth in the region.
- Downtown accounted for 96% of job increases during this period by adding 64,650 net new jobs as Downtown jobs grew by 21%.



DOWNTOWN EMPLOYMENT GROWTH AS A PERCENTAGE OF DC EMPLOYMENT GROWTH, 1997-3Q 2007

	Employment Increase		Downtown as a % of DC Increase
	DC	Downtown	
1997	-4,600	4,000	-
1998	-4,900	8,800	-
1999	13,900	5,500	40%
2000	22,800	10,250	45%
2001	3,500	5,300	151%
2002	10,500	5,600	53%
2003	1,300	8,000	615%
2004	8,700	4,200	48%
2005	8,000	5,000	63%
2006	6,100	5,000	82%
3Q 2007	2,100	1,500	71%
Total	67,400	64,650	96%

SOURCES: Center for Regional Analysis (for Downtown for years 1996, 2001, 2003 and 2006); and DC for 2006; Bureau of Labor Statistics for DC for 1999-2005 and 3Q 2007); and Downtown BID (for all other Downtown for all other years)

- The Downtown BID area, in particular, grew by 57,000 jobs—from 120,000 to 177,000—raising its share of total employment in the city from 20% to 26% as new employees filled new office buildings, restaurants and retail stores from 1996 through 2006.

- Job growth in the Downtown BID area outpaced not only that of the District of Columbia but also the region as a whole, reflecting Downtown's renewed importance as a major regional employment center. From 1996 through 3Q 2007, the 48% increase in jobs in the Downtown BID area was more than four times that of the city as a whole (10%), and double that of the region (24%). From 2003 through 2006, the CRA study shows Downtown BID employment growing 8.2%, while DC grew 4.5% and the region grew 6.6%.

➤ Downtown and the District of Columbia continued to experience growth in high-value jobs. The average salary of a job in Downtown Washington rose from \$62,000 in 2003 to \$75,000 in 2006. Many of these new DC employees live in new Center City housing and spend their retail dollars in the city.

- The fastest growing job sector in Downtown was legal services, with 42% growth from 2003 through 2006, or 12,300 jobs. These jobs reported average annual pay of \$122,500 in 2005.

➤ Downtown also has a range of job opportunities for people at all skill levels:

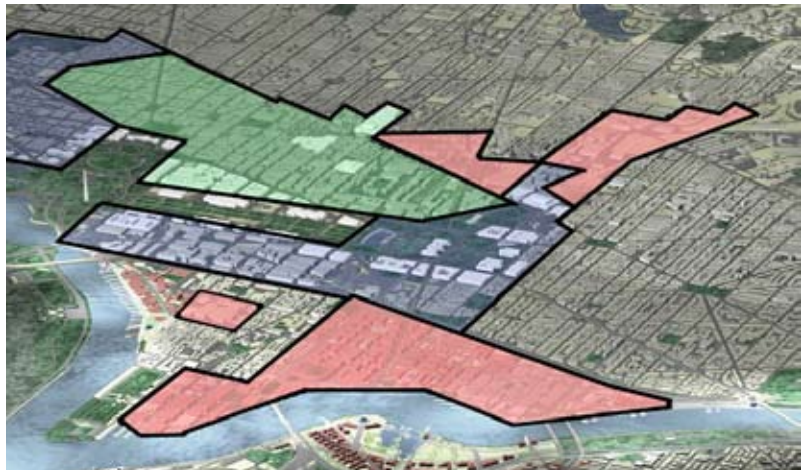
- The third fastest growing job sector in Downtown (behind legal and education services) was retail trade, with 30% growth from 2003 through 2006, or 1,700 jobs. Redevelopment along the 7th Street corridor and at the Woodies Building and Gallery Place were the main retail job generators. For example, a recently opened retailer hired 130 employees, of whom 69% are DC residents.
- Downtown has 26,900 hospitality jobs. Assuming a 20% turnover in employees per year, the hospitality sector provides more than 5,000 job openings per year.

As impressive as the rise in employment has been, DC still has an enormous opportunity to capture a larger share of the region's employment growth. CRA estimates that DC over the next four years will capture fewer than one in seven of all new jobs added to the region—only 19,400 out of 148,500 new jobs.

Office Development

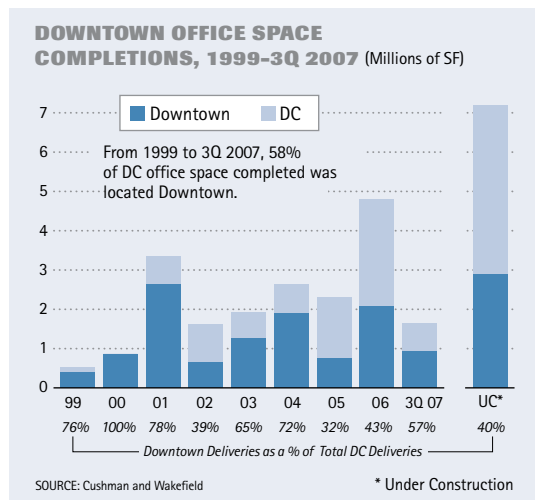
This dynamic increase in jobs continues to expand commercial development in the city, especially in the Downtown area.

➤ From 1999 through 3Q 2007, Downtown added 11.5 million square feet (SF) of new office space, accounting for 58% of DC's 19.7 million SF increase in privately owned office space during the same period.



DC's Center City Office Markets

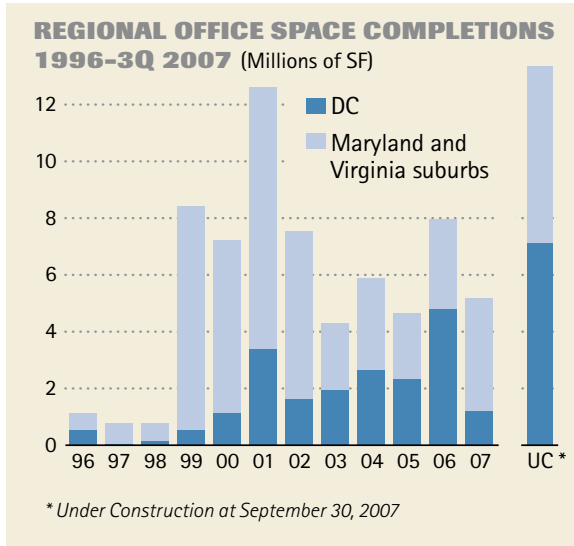
■ Established Center City Markets ■ Emerging Center City Markets ■ Downtown



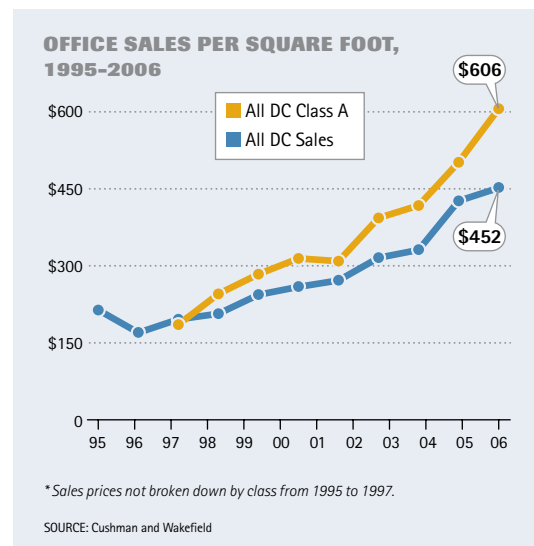
➤ Throughout the 1970s, 80s and 90s, DC had been losing its market share of regional office space. From 2002 through 2006, DC gained market share back from the Virginia and Maryland suburbs. According to a Brookings Institution study, DC is one of only a few major cities in the country that can make such a claim.

➤ Downtown's commercial office market moved to the forefront on financial performance in comparison with other cities in the United States. As of September 30, 2007, Downtown ranked third nationally in Class A office rents at an average of \$56 per SF, behind Manhattan at \$72 per SF and Downtown Boston at \$64 per SF, while DC as a whole ranked fourth at \$52 per SF. Downtown DC ranks third in office occupancy, with a 5.5% Class A vacancy rate, compared to Manhattan at 3% and Bellevue, WA at 3.8%, while DC as a whole ranks 11th with a Class A vacancy rate of 7.8%.

Commercial real estate sales values have risen significantly. Figures show that DC's Class A office space sales values increased from \$170 per SF in 1997 to \$606 per SF in 2006.



SOURCE: Cushman & Wakefield



For the past five years, the Association of Foreign Investors in Real Estate has ranked Washington among the top markets in the world in which to place global capital in commercial markets.

Fiscal Impact

The increase in Downtown employment and commercial development has had a profoundly positive impact on the DC government's fiscal performance.

From 2000 through 4Q 2007, office real property taxes in DC grew from \$275 million to \$652 million, accounting for 19% of DC's growth in gross local revenues.

During the same period, annual office deed recordation and transfer taxes in DC grew from \$57 million to nearly \$175 million, accounting for 6% growth in gross local revenues.

In total, office-generated taxes accounted for one-quarter of gross local revenue growth from 2000 through 4Q 2007, or \$495 million out of \$1.97 billion.

Much of the city's rising fiscal fortunes have been built upon this foundation of additional taxes from office property.

Like all world class downtowns, Downtown Washington, DC, not only provides places for residents to work, shop and visit, but its tax revenues support services that also help make DC neighborhoods viable and successful. Downtown generates much more in tax revenues than it costs the DC government in services. This is what the downtowns of all world-class cities do—provide economic and fiscal support for surrounding neighborhoods and communities.




In order to grasp Downtown's fiscal impact on the city overall, the Downtown BID engaged Economics

OFFICE GENERATED TAXES GROWTH AS A PERCENTAGE OF TOTAL DC GROSS LOCAL REVENUE GROWTH, FY 2001-FY 2007

	Increase in DC Gross Local Revenues	Revenues Office Generated Taxes	Office Generated Taxes as % of DC Gross Local Revenues
2001	\$253	\$19	8%
2002	(\$128)	\$40	-
2003	\$191	\$111	58%
2004	\$396	\$61	15%
2005	\$540	\$8	1%
2006	\$289	\$98	34%
DC Estimate 2007	\$427	\$158	37%
2001-2007	\$1,968	\$495	25%

SOURCES: Office of Revenue Analysis (Office of the Chief Financial Officer); 2008 Fiscal Year Budget (June 7, 2007); September 6, 2007 Revenue Estimate by Office of the Chief Financial Officer; and Downtown BID.

Research Associates in 2007 to conduct a detailed study. The study examined all local tax revenues generated by Downtown and all DC government expenditures on Downtown. The study reported that:

-  Downtown generates \$1.179 billion in revenues annually for the DC government, including commercial property taxes, sales taxes, parking fees and lottery revenues—22% of total city revenues.
-  Downtown receives \$555 million worth of services annually from DC government, including police, fire, sewer, Metrorail and Metrobus.
-  For fiscal year 2007, Downtown's net fiscal impact was \$624 million. For the purpose of comparison, this figure is equal to the entire budget of the Metropolitan Police Department, or 58% of the DC Public Schools' locally funded budget.

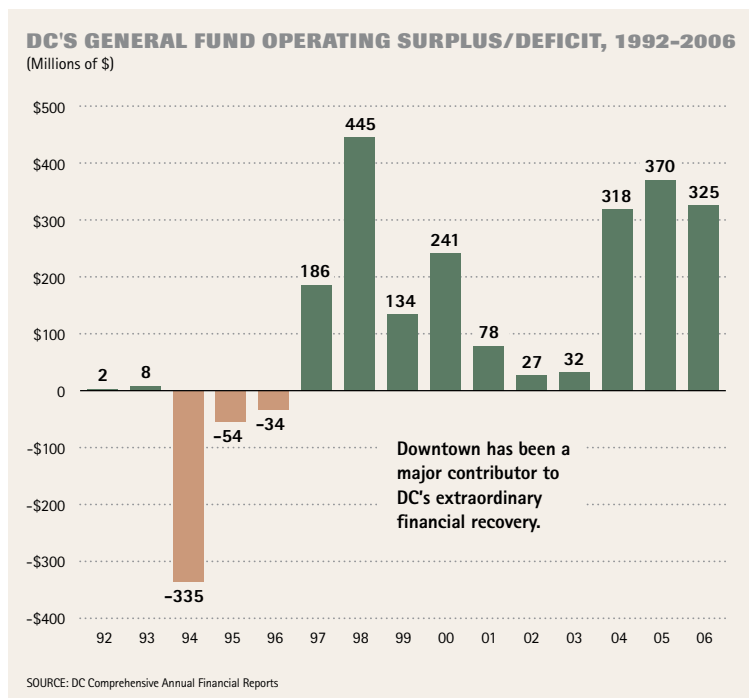
DOWNTOWN'S NET FISCAL IMPACT, FY 2007	
Downtown BID Area	
DC Local Tax and Other Revenues	\$740
Estimated Fiscal Costs	\$404
Net Fiscal Impact	\$335
Golden Triangle BID Area	
DC Local Tax and Other Revenues	\$439
Estimated Fiscal Costs	\$151
Net Fiscal Impact	\$288
Total Downtown Area	
DC Local Tax and Other Revenues	\$1,179
Estimated Fiscal Costs	\$555
Net Fiscal Impact	\$624
Downtown Revenue Share of Total DC Gross Local Revenue of \$5.38 billion in FY 2007	22%

The DC government has projected annual budget growth of 5.6% for 2006 through 2011, with property tax growth of 20% in 2007 and 15% in 2008. If the DC government is to meet its targeted program goals, then the Center City must continue to grow at a rate similar to what it has experienced over the past 10 years.

Leveraging Public Investment

During the past decade, the DC government selectively has used public investment to support Downtown job growth, commercial development and fiscal impact. From 1996 through 2005, the DC government invested an estimated \$400 million in Downtown in support of the Verizon Center, the new Convention Center, Gallery Place, Sidney Harman Hall and other Downtown arts, retail and infrastructure projects. In addition, the DC government is investing millions of dollars in emerging markets in Mount Vernon Triangle, NoMa and the Capitol Riverfront. Public investments have come in a variety of forms, e.g., using public land for the Verizon Center and new Convention Center, tax abatements for market-rate housing, tax-increment financing (TIF) for Gallery Place and Downtown retail, and payments-in-lieu-of-taxes (PILOTs). In addition, the federal government has invested \$300 million in Downtown.

These public investments worked to leverage \$10 billion in private investment, which has produced a public benefit to the entire city. The total investment, in turn, has generated a flow of approximately \$400 million in new annual taxes in fiscal 2007 and a cumulative total of \$1.6 billion in new taxes from 1996 through 3Q 2007.



Thus, Downtown is today a powerful engine whose impact is far ranging and worth continued public investment to maintain its economic and fiscal benefits.

Challenges Ahead

The District of Columbia has enjoyed an incredible renaissance during the past decade, primarily in and around its Downtown area. In addition to creating a more vibrant Downtown, the result has been an extraordinary positive fiscal jolt that has allowed the DC government to make significant and essential investments in the public school system and other social services, such as public health and affordable housing.

As Downtown nears full build out—with the old Convention Center site, headquarters hotel and two to three other sizable projects scheduled for development in the next five years—the area’s economic and fiscal impacts will continue to be strong, barring sudden changes in the economy or in public policy toward Downtown.

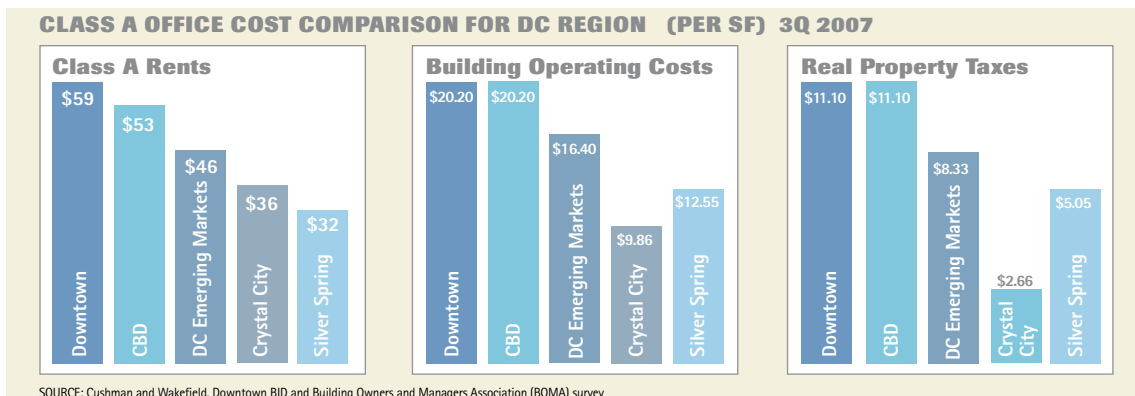
A 2005 Delta Associates’ DC office market study, funded by the DC government and the Downtown BID, made the following five “big picture” recommendations to maintain and improve the DC office market’s health:

- Assure that the Washington Metropolitan Area Transit Authority increases the number of subway cars now, and in the future addresses the issue of track and tunnel capacity to support commuting workers.
- Increase the resident labor force and reduce the city’s dependence on suburban workers by making the city more livable—starting with fixing the school system.
- Promote a more diverse office tenant base through programs aimed at reducing occupancy costs and recruiting new or underrepresented industry sectors.
- Try to attract government contractors to DC by competing with the suburbs on cost and providing assistance in finding affordable space.
- Maintain a well managed, financially sound city government that is responsive to citizens and the business community.

If DC wants to increase Downtown’s fiscal impact and move development to emerging Center City markets in Mount Vernon Triangle, NoMa and the Capitol Riverfront, city leaders must monitor closely three immediate issues: taxation, infrastructure and quality of life:

Level of Taxation

There is a growing disparity in rental costs between expensive office space in Downtown DC and less expensive space in neighboring jurisdictions. Much of the price differential is the result of higher DC property taxes that are passed along to tenants.



Although the DC government benefits from the increased revenues, higher property taxes per SF (up from less than \$6 per square foot in 2002 to \$11 per square foot in 2007) are beginning to cause those tenants with expiring leases—or those looking for new office space—to consider more favorable rents in surrounding jurisdictions. The rent differential between Downtown and nearby suburbs now has reached \$20 to \$25 per SF, of which \$3 to \$9 per SF is attributable to the difference in office property taxes.

Although DC occupied office space has grown substantially by 2.1 million SF per year from 2001 through 3Q 2007 (a total of 12 million SF), the growth in occupied office space could have been greater had some tenants not left DC for the surrounding jurisdictions. 2 million SF of office space has been vacated over this same time period, or will soon be vacated, by DC tenants leaving DC, and 300,000 SF of office space has been occupied by new tenants coming to DC; thus, DC has had a net “loss” of 1.7 million SF of occupied office space. The 2 million SF of office space occupied by tenants having left, or soon to leave DC, represents a tax revenue opportunity cost to the DC government of \$35 million per year.

Infrastructure in Emerging Markets and Downtown

If significant job growth, commercial development and fiscal impact are to continue at robust rates in DC, growth must move from Downtown to emerging markets, especially those surrounding Downtown: Mount Vernon Triangle, NoMa, the Capitol Riverfront and Southwest.

However, these areas lack proximity to Downtown’s amenities and public infrastructure (multiple Metro lines and other public transit, attractive and complete streetscapes, water and sewer infrastructure, parks, retail, restaurants, entertainment, etc.), and need significant public investment in these amenities and infrastructure. Much of the infrastructure has been planned, and some has been approved. More investment is needed if these emerging markets are to compete with the kind of amenities now found in Crystal City, Rosslyn, Silver Spring or other suburban markets, which present keen competition. New transportation and streetscape infrastructure, in particular, is needed to connect emerging markets to Downtown.

It is imperative that DC invests in its emerging markets to properly seed a critical mass of new development, ensuring that these areas of high tax revenue and low cost can grow.

Quality of Life

In addition to benefiting from economic revitalization during the past decade, Downtown has experienced significant improvement in its quality of life. A public environment that could have been characterized as “dull, dirty and dangerous” in 1997 now can be characterized, for the most part, as “clean, safe and friendly.”

The reasons for the improved quality of life are many: an increased number of Downtown residents with “eyes on the street” private and public investment that has turned parking lots and abandoned buildings into productive assets, and the programs generated by public-private partnerships between DC government and business improvement districts.

It is critical that both the public and private sectors continue to focus on quality of life issues if the Downtown economy is expected to prosper. Key areas of concentration must be cleanliness, public safety, homeless services, streetscape and park investment, maintenance and programming.

It will take considerable resolve and discipline to ensure that the correct balance of taxation and public investment continues in the future; however, it is essential in order for DC to fund and achieve many of its important social and economic goals for all of its citizens. With proper public investment, a reasonable goal would be for DC to grow its net fiscal impact from \$624 million per year today in Downtown to a center city net fiscal impact of more than \$1 billion in five years and \$1.5 billion in 10 years.



The authors are Richard H. Bradley, executive director of the Downtown DC Business Improvement District, and Gerry Widdicombe, director of Economic Development at the Downtown BID.

For additional information, please contact Gerry Widdicombe at 202-661-7597 or gerry@downtowndc.org. For a copy of the report and appendices, visit www.downtowndc.org/economicengine.

Special thanks to Rebecca White, Economic Development research associate for the Downtown BID; Wayne Nicolosi, Downtown BID electronic media specialist; and Farahana Hossain, graphic arts consultant, for their assistance with this publication.

The Downtown DC Business Improvement District (BID) is a private, nonprofit organization that provides safety, hospitality maintenance, homeless outreach, economic development, transportation, streetscape and marketing services to a 140-block area of Washington's center city. The BID promotes Downtown DC as a premier commercial, cultural, entertainment and residential destination.



Business Improvement District
(202) 638-3232
info@downtowndc.org
www.downtowndc.org

Downtown DC Business Improvement District
1250 H Street, NW Suite 1000
Washington, DC 20005-3952