PLAN ECONOMICS

OCTOBER 2006

Overview

The District of Columbia is in the midst of an ambitious initiative to develop 55,000 new housing units over a 15-year period, with the goal of increasing its population by 100,000 by the year 2020. This goal was initially identified by Mayor Anthony Williams in his 2003 second inaugural address, a response to the District's stagnant and declining population during the 1990s, but has since been further defined by the Comprehensive Housing Strategy Task Force. Over the past five years, the District has been on a strong trajectory to meet this goal with infill construction occurring in most areas of the city. These additional residents contribute to a more dynamic community and bring additional tax revenue to the District, helping to offset the cost of local services and the deficit caused by a local, regional and federal workforce that largely lives outside the city and does not pay local taxes.

With the District of Columbia continuing to be one of the nation's strongest office markets, market dynamics encourage the development of office space. Balancing this with a resident workforce and creating the type of healthy, sustainable, 24-hour neighborhood desired by the District requires a critical mass of residents in addition to a daytime population of workers. Downtown's central business district, for example, has become much more interesting and sustainable since residential development, entertainment and retail ammenities have brought activity that extends beyond the typical workday. The envisioned NoMA neighborhood offers the potential to create an equal mix of office and residential development, with the retail necessary to support both.

At full build-out, the NoMA area – as defined in this report on page 1.2 – is capable of supporting between 20 million and 30 million SF of new development. This assumption is based on current zoning and recent zoning requests in NoMA's Planned Unit Development applications. A conservative assumption of 20 million SF of new development, evenly split between office and residential (10 million SF of each), would suggest – again, conservatively – the need for 300,000 SF of retail to support the mix. NoMA may also present opportunities for much larger format retail, particularly if the air rights behind Union Station and large sites along New York Avenue are redeveloped in the near term.

General Market Conditions

The NoMA area has the potential to develop millions of square feet of space in any number of directions in the next 5 – 15 years. This could occur in a relatively short period of time given the large number of cleared and developable sites, establishing in the near term the type of area this will become in terms of uses and character. The potential impact of market shifts in this sensitive environment is great, however market forces may also be influenced through a variety of public sector interventions, including catalytic incentives, in order to accomplish the goal of a dynamic mixed-use neighborhood as is recommended.

Office Market

On a regional and city-wide level, the Washington DC office market is strong and signs are strong for future growth. An Office Market Study completed for the the Downtown BID in 2005 by Delta Associates noted annual office space absorption of more than 2 million SF per year in the District alone over the last twenty years. In addition, there has been continued strength locally and nation-wide in the District's core employment sectors of government, services, and tourism, with more than 70,000 jobs added in the region in the last several years. Finally, the District's efforts to establish a more open local government and better local services have made the District more attractive than in the past relative to competitive suburban locations.

Looking forward, there are strong indicators that this growth trend will continue. The Downtown BID's study suggests an estimated 1.8 million SF of new office space absorption annually through 2030 in the District alone. This is in the context of a regional market with tremendous growth. Indeed, the District is expected to lose market share even as it adds a huge amount of new inventory. With the exception of some military contractors in the suburban areas, growth trends are also encouraging for the primary employment sectors that supply office workers in the District. This is echoed by local developers, who have continued to build new office inventory, and have seen strong leasing activity in recent years.

As the historic office core fills in, NoMA is ideally positioned to serve as an outlet for this potential growth, indeed, the growth of the District may depend on this area. The NoMA corridor offers excellent connections to mass transit through Metrorail and Union Stations as well as immediate access to the regional roadway system. In addition, the area offers proximity to Capitol Hill and the downtown office core. These factors suggest great growth potential. More importantly, developers active in the area suggest that rents for new high-end buildings in the area could be $38-$45 per SF, compared with rents over $60 per SF for prime locations downtown and a $41 per SF average for the District as a whole. This would offer potential tenants a newly constructed building for a rent level equivalent to some class B properties in other locations. Clearly, this opportunity has the potential to attract some tenants who would otherwise locate in other sub-districts, or who would leave the District altogether, including non-profits and associations.

Potential procurement actions by GSA will have a significant impact on the future development of NoMA. Throughout the District, federal tenants remain an important driver of office demand, including approximately 20 million SF of leased space in the District, and more than 50 million SF of leased and owned space in the metropolitan area. The importance of this market is amplified by the tendency of many contractors to locate in immediate proximity to federal agencies. In NoMA, construction of the 430,000 SF headquarters building for ATF suggests that the General Services Administration (GSA) – the federal agency responsible for the real estate needs of the federal government – understands the potential of this area. Given the security demands of federal tenants and the large potential land areas relative to occupiable square footage, further GSA activity in the area may mean primarily low Floor Area Ratio (FAR) office buildings. In addition, security requirements are often achieved in ways that are in clear conflict with the development goals for NoMA, including high-density development, retail services, and active streets.

GSA tenants requiring high levels of security may result in projects with setbacks, limited access at street level, and intrusions into public space. Any special security requirements need to be incorporated in a way that do not work against the type of pedestrian-friendly, street-facing retail and mixed-use development that is is the goal for NoMA. The District and the development community should continue its work with the National Capital Planning Commission to encourage innovative design solutions for GSA projects with security requirements, illustrating how this valuable office tenant can contribute to a lively, active, urban neighborhood. (See pages E.1-E.3 in the Appendix.)

Residential Market

In parallel to the strong office market, the District has had a dramatic increase in the downtown housing market. The level of renovation and new construction activity downtown continues to surprise even seasoned local developers. Broad improvements to quality of life, service delivery, and local amenities have greatly increased demand for residences in formerly marginal or non-residential areas of the city. For example, according to the Downtown BID, approximately 7,000 units of new housing are either under construction or planned on top of an existing inventory of approximately 4,000 downtown units. The demand for these units has pushed condominium sales prices above $600 per foot in some cases, and monthly rental prices above $2.50 per foot. At these prices, the profitability to a developer of for-sale housing or office developments can be comparable, depending on the specifics of the site. Rental housing still offers a lower return than either for-sale housing or office development.

For NoMA, location and transit access suggest that trends downtown and in the Capitol Hill area are likely to expand into NoMA. The same transit and roadway assets that make NoMA attractive as an office location are likely to drive strong demand for residential development. Local developers suggest that they have a very favorable and optimistic perspective about the demand for new residential development in the area, though the overall residential market in the District and the region is softening.

Retail Market

Demand for mid-size and larger destination retailers is strong throughout the region, while within micro-market, retail demand is determined by broader trends regarding prevailing uses within the neighborhood. The District is broadly perceived to be "under-retailed" in terms of square feet of retail space per resident. This is particularly true of larger format retail stores, which District residents (and their tax dollars) currently seek in suburban locations.

As the team has investigated the potential for this and other retail within the NoMA sub-district, we have found that developers have focused on three issues beyond the existing market demand which are likely to influence the eventual retail development in the area:

1. Uncertainty regarding the residential and retail composition of NoMA development projects leads to uncertainty about the desired retail tenancies. While most owners and developers in the area express an interest in a full-service retail environment, it is clear that their individual decisions about the type of retail space they will build and the types of tenants they will seek will not be determined until they have a clearer sense of the composition of residential and commercial space in NoMA more broadly. This will be particularly true if there is a significant amount of GSA tenancy, which may cause generally smaller and more dispersed retail frontage.

2. The realities of existing building height limits impact the ability of developers to recognize their preferred return if they include the type of retail spaces that create value for the District long-term. Several developers noted that the existing height limit allows them to build thirteen-story buildings, providing ceiling heights no greater than ten feet on the ground floor. This decision, while presumably economically rational in the short term, is likely to make the area less attractive to larger national retailers that prefer higher ceilings. Creating higher-ceiling retail spaces could prevent these developers from building the maximum number of floors, and is perceived as a loss of value for the buildings. Confining the higher-ceiling area to high impact corners and other limited areas along key streets may partially address this market reality.

3. Major retail anchor opportunities are distinct from, and dependent upon, the incremental development of neighborhood-serving retail in the ground floors of office, residential and hotel projects. Significant destination retail is anticipated for the air rights over Union Station. Large-scale retail development is also viable at either end of NoMA's North Capitol Street – on the site of the soon-to-be-vacated Government Printing Office south of H Street and on both sides of New York Avenue between North Capitol and 1st Street. The nature and timing of this development will rely on the pace and mix at which NoMA's core is built out to provide a base of shoppers for the larger retail projects.

Hotel Market

With one hotel already planned, NOMA may well see further hotel activity as the market matures. Development of hotels in NoMA is likely to respond to the trend in the rest of the District as the area is built out further. In general, the District hotel market has been strong, and NoMA's direct transit access, proximity to the core, the federal government complex, and tourist attractions on the Mall suggest that the area could develop as a desirable hotel location. However, the likely viability of the area for hotels will be dependant on the area's image, perception of safety, adequate infrastructure and the development of restaurants and other amenities that successful hotels require as attractions for non-business travel guests. The primary question is not likely to be whether or not NoMA sees further hotel development, but rather whether that development is strictly to serve business travelers or a broader market.

Market Conclusions

The combination of strong demand in a variety of sectors and no overwhelming demand in any single segment presents an invaluable opportunity for NoMA to grow long-term. Initial market investigation suggests that market demand in NoMA is well positioned to provide the type of mixed-use and multi-purpose neighborhood that is likely to be sustainable and vibrant over the long term. The size of the development lots suggests that many projects will consist of multiple buildings, which provides developers with the opportunity to create mixed-use projects as a way of maximizing their financial returns and mitigating a downturn in any particular sector.

Whatever this potential may be, recent experience suggests that the current market environment is not in sync with the longer term objectives of developers in the area. During the period of our initial market reconnaissance, we have seen one speculative office building that remains unleased, and other projects that remain unfinanced due to the lack of 100,000 SF of pre-leasing. These very important data points suggest that while there is great excitement amongst developers in NoMA, they have not been able to attract tenants under the current area image, terms and market conditions.

In addition, non-profits and associations are leaving the District and NoMA may play an important role in providing headquarter locations for this sector of the market.

The full development of NoMA depends on reaching a compelling, shared vision to improve the public realm and create a cohesive and active neighborhood. Recent history in Mount Vernon Triangle, the Southeast Federal Center, and other areas of Washington demonstrates the power of a strong vision and development expertise to open a vein of untapped demand. Initial market analysis suggests that NoMA has the potential to become a dynamic new neighborhood, but the current poor street and public realm conditions and lack of local infrastructure and amenities are likely to be an impediment to that potential. Our task is to ensure that a vision is in place and that actions are identified to assist in the creation of a neighborhood that addresses all of the District's policy and development goals over the long term.

NoMA's Strengths, Weaknesses, Opportunities & Threats

As noted throughout the NoMA planning process, the area exhibits significant strengths and opportunities to develop a stabile, lively new neighborhood. To achieve this goal, however, development must be managed in a way that corrects certain market weaknesses, addresses competitive opportunities in the area and takes steps to counter threats to the long-term viability of the area.

Strengths

NoMA's strengths include its strong transportation connections, its access to downtown and Capitol Hill, the presence of landmark structures and a strong, active stakeholder group that has already committed to working together to meet the challenges of developing in NoMA. Each of these can be built upon to further enhance the appearance, vitality and appeal of this area.

- NY Avenue Metrorail Station
- Union Station (AMTRAK, METRO, VRE and MARC)
- Structured public parking at Union Station
- Retail concentration at Union Station
- Bus station
- Highway access off of New York and Florida Avenues and North Capitol Street
- Proximity to Downtown and the Capitol Complex
- Uline Arena and other historic assets including proximity to Florida Avenue Market
- Metropolitan Branch Trail
- Vacant land
- Surrounding residential neighborhoods
- NoMA Stakeholders Group

Opportunities

Fortunately, each of NoMA's weaknesses also presents a corresponding opportunity. In particular, vacant land provides a clean slate on which to plan a finer-grained, pedestrian-friendly street grid without disrupting existing structures. It also allows for neighborhood-wide urban design approach that identifies preferred sites for public spaces before building plans are finalized. The lack of recent street improvements makes it much easier to approach the area's traffic concerns in a way that will not only address specific streets and intersections, but also the larger issues of how to manage traffic flow to minimize negative impacts on the surrounding residential neighborhoods.

Overall, NoMA's clean slate makes it realistic to plan for the type of 24-hour neighborhood that would best serve the District and its residents. It is a rare opportunity in an already densely developed city to be able to plan for an even mix of residential and office development, with retail located in a way that creates a gathering place for neighbors and office workers. NoMA also offers an ideal location for the District to address its relative lack of hotel rooms as part of a well-integrated development plan.

All of these elements would also offer the District an opportunity to generate a diverse mix of new jobs for District residents. In particular, retail and hotel employment would provide opportunities for many residents of nearby neighborhoods to find work within walking distance or a short commute.

- Mixed-use development, including residential, hotel, and retail
- Office development, including associations and non-profits
- Finer grained street grid
- Pedestrian-friendly retail and streets
- Redesign of Florida Avenue – New York Avenue intersection
- Public spaces
- Architectural richness and diversity
- New Job Creation
- Potential to achieve design excellence, plan implementation and other community benefits through PUDs
- Sculptural uniqueness of historic stone wall
- Two-level city based on Metropolitan Branch Trail

Weaknesses

Among the most obvious of NoMA's current weaknesses is the large amount of vacant land, which, along with the poor street, sidewalk and stormwater infrastructure, creates an immediate visual disincentive for either residential or office users to choose NoMA. The area's network of "super-blocks" adds to the current unwelcoming feel of the area – particularly for pedestrians. The area currently lacks retail and other amenities and services, as well as public spaces for either recreation or leisure.

- Vacant land
- Poor infrastructure (streets, sidewalks, stormwater)
- Lack of visibility and access to new Metrorail Station
- Lack of services and amenities
- Lack of recreation or public space
- Super-blocks
- Inhospitable pedestrian environment
- Feels unsafe

Threats

Of course, taking advantage of all the opportunities NoMA offers will not be without its challenges. Market forces may encourage developers to pursue office development disproportionately, or to delay development in a way that hinders the critical mass necessary to the success of those who do develop. Federal government security requirements may result in construction of fortresses, with deep setbacks and no pedestrian interaction, and single use buildings without retail. Retail could be developed in a piecemeal manner, with ground floor spaces in buildings designed in a way that will never be suitable for the type of retail needed once the area is fully built out. In the absence of specific development guidelines, high-rise structures could be built immediately adjacent to lower scale residential neighborhoods, destroying the feel and culture of traditional communities.

- Office canyons, populated only from 9-to-5
- Delayed development
- Security-driven fortresses and single use buildings
- Poorly designed security installations that disrupt public space
- Limited retail mix, lack of services
- Inappropriate building heights and uses in sensitive areas
- Oversized superblocks that discourage pedestrian travel
- Traffic congestion
- Lack of adequate public investment in infrastructure

Potential Impact of NoMA Development

To quantify whether it is, in fact, worthwhile to take advantage of the opportunities presented by NoMA, an independent analysis has been completed of the fiscal and economic impacts of potential development of property within the NoMA study area. This analysis considered the impact with development occurring over either a 10-year or a 20-year build-out period. It was assumed that development would occur in accordance with the city's expressed preference for an equal amount of residential and commercial (office) development in the area, and based its analysis on development program assumptions previously discussed with District officials and on publicly available information on District tax rates and policies.

The analysis depicted below illustrates this information in terms of tax revenue collected, a 10 year build-out generates significantly more gain than a 20-year build-out with receipts spread over 20 years in both scenarios. This difference, $313,200,868, illustrates the importance of development catalysts that incentivize projects now rather than later. NOTE: Tax revenue projections are discounted to 2006 value.

Taxes Collected

Assuming a 10-year build-out of the area, $494 million of tax revenue would be collected in NoMA over 10 years and $975 million collected over 20 years. Assuming a 20-year build-out, $325 million of tax revenue would be collected in NoMA over 10 years and $662 million collected over 20 years.

Summary of Fiscal Impact: NoMA Development

	Cumulative Taxes Collected (in 2006 dollars) 10-Year Build Out		Cumulative Taxes Collected (in 2006 dollars) 20-Year Build Out	
Tax Source	**Over 10 Years**	**Over 20 Years**	**Over 10 Years**	**Over 20 Years**
Income Tax	$53,625,223	$134,969,758	$26,812,611	$77,822,301
Unemployment Insurance Tax	$15,833,838	$38,243,664	$8,333,599	$23,341,207
Real Property Tax (Construction)	$80,419,511	$80,419,511	$107,949,182	$119,796,351
Real Property Tax (Residential)	$69,094,068	$166,883,754	$34,547,034	$96,761,254
Real Property Tax (Commercial)	$88,120,626	$212,838,833	$44,060,313	$123,406,575
Hotel Tax	$28,262,468	$57,566,895	$21,952,034	$43,207,268
Motor Vehicle Excise Tax	$1,926,267	$1,926,267	$1,926,267	$1,926,267
Sales & Use Taxes	$53,946,118	$130,296,722	$27,485,764	$76,983,655
Public Utility Tax	$6,806,317	$16,439,382	$3,403,159	$9,531,756
Deed Recordation & Transfer (Land)	$9,919,526	$9,919,526	$4,959,763	$7,135,611
Deed Recordation & Transfer (Condos)	$86,253,746	$125,397,917	$43,126,873	$81,789,115
TOTAL	$494,207,709	**$974,902,228**	$324,556,600	**$661,701,360**

Employment

An additional 75,926 construction jobs (or 7,593 jobs per year over a 10-year build-out) and an additional 857 permanent retail jobs would be generated by full build-out of the NoMA area. Assuming, conservatively, that 25 percent of these jobs will go to District residents, this means an additional 18,982 construction jobs and an additional 214 retail jobs for District residents.

Summary of Employment Impact: NoMA Development

Employment Source	Jobs Created (FTE)	Annual Jobs Created 10-Year Build-Out	Annual Jobs Created 20-Year Build-Out
Construction	75,926	7,593	3,796
Office (New to DC)	35,889	3,589	1,794
Permanent Retail (New to DC)	857	86	43
TOTAL	112,672	11,267	5,634
Prepared By: The Jair Lynch Companies (August 2006)			

Spending

An additional $235 million of annual retail spending (city-wide, not just in NoMA) would be generated by new District residents and office workers located in NoMA. NoMA residents and workers would also generate an additional $14 million of annual Metro spending. Assuming 25 percent participation by LSDBE contractors in the design and construction of NoMA's many projects, an additional $2 billion in development revenue could go to LSDBE contractors over the full build-out of the area.

Summary of New Spending: NoMA Development

Source of Spending generated by NoMA	New Spending from NoMA	Annual New Spending from NoMA 10-Year Build-Out	Annual New Spending from NoMA 20-Year Build-Out
Annual Retail Demand (New Residents)	$34,031,250	$3,403,125	$1,701,563
Annual Retail Demand (New Office Workers)	$186,622,222	$18,662,222	$9,331,111
Annual Metro Usage (Residents & Office Workers)	$14,395,833	$1,439,583	$719,792
Construction Revenue to DC Contractors (25% LSDBE Participation)	$2,050,000,000	$205,000,000	$102,500,000
Prepared By: The Jair Lynch Companies (August 2006)			

Program: Assumptions for Economic Input

The development program proposed by the DC Office of Planning is the basis for this analysis. Basic details of the program include:

RESIDENTIAL
- 10 million SF of residential
- Average SF per household = 1,000 SF
- Number of new households = 10,000
- Affordable component = 8% (4% at 80 AMI and 4% at 50 Area Median Income(AMI)
- Assumes all units are for-sale, not rental.
- Market rate sales price = $500 per SF

COMMERCIAL
- 10 million SF of office
- 300,000 SF of retail

PARKING
- Parking development costs not included.
- Parking space sales prices (for residential units) not included.
- 20,000 commercial parking spaces.
- Rent = $10 per day per space, 350 days per year.

HOTEL
- 1,600 hotel rooms
- 4 hotels, 400 rooms each

Implementing