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Business Improvement District

Testimony of the Downtown DC Business Improvement District
Subcommittee on Economic Development, Public Buildings and Emergency Management
Committee on Transportation and Infrastructure
U.S. House of Representatives
The Hon. Eleanor Holmes Norton, Chair
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Thank you Madam Chair for the opportunity to be part of today's session. My name is Mitchell N. Schear and I have been active in the Downtown DC Business Improvement District since its formation in 1997. The Downtown Business Improvement District is a not-for-profit corporation that works to improve a one-square-mile area of Downtown Washington, DC that includes 62 million square feet (SF) of office space. Within that area, the U.S. General Services Administration (GSA) owns 17 million SF and leases an additional 7 million SF. I am also President of Vornado/Charles E. Smith, the Washington DC Office Division of Vornado Realty Trust, and we are the largest lessor of office space to the federal government in the Washington DC area. Vornado Realty Trust is a fully integrated real estate investment trust (REIT), one of the largest owners and managers of real estate in the United States, with a portfolio of over 100 million square feet.

Your decision to hold this hearing today is timely because in conference rooms throughout the country the banks, developers, property owners, insurance companies, REITs, the U.S. Treasury, the Federal Reserve, GSA and BIDs are discussing "the serious commercial real estate credit crunch." For many cities and regions, and DC in particular, the private sector works actively to respond positively and collaboratively with GSA as it manages its leasing and building programs. GSA is a key partner in our the commercial real estate sector. During the global economic crisis we believe it is critical to meet federal needs for the delivery of good government services and workforce attraction. In doing so the commercial real estate industry also benefits from the increased stability of a federal presence, and that serves to protect the hundreds of thousands of jobs across the country linked to the commercial real estate industry.

Let me first thank Representative Norton and GSA for their work on behalf of DC and the region. Congresswoman Norton's commitment to expanding locational options for GSA in DC (the move of the Department of Transportation to Federal Center SouthEast, the building of the new Bureau of Alcohol, Tobacco and Firearms headquarters in NoMa, and the plans for the Department of Homeland Security at site of the historic St. Elizabeth's Hospital) have created lower-cost and efficient options for GSA's federal agency clients, as well as new anchors in emerging markets that are good for the environment and take advantage of existing infrastructure—all good for the American taxpayer.

GSA has continually improved its leasing operations to become more transparent and efficient. It also has improved the quality of life in DC and the region by building attractive and innovative facilities, and the location of facilities near public transit or other existing transportation options. GSA also has assumed the role of a global leader in "green" research and development as it works to make its buildings, and the buildings it leases, more friendly to the environment. GSA's Good Neighbor Policy has supported the Downtown DC BID and other business improvement districts throughout America. None of us would be able to do as much as we do without GSA's support.

Commercial Office Real Estate Market

Throughout America, commercial real estate is seeing rising vacancies (as employment declines) and flat or declining rents. In addition, commercial real estate financial markets are frozen. With the banks and insurance companies in a very weak condition and the disappearance of the commercial mortgage backed securities market ($250 billion of financing in 2007 and only a few billion of issuance in 2008), there is almost "no money for nobody" as was last experienced during the savings and loan crisis in the early 1990's.

To make commercial real estate funding available again, we urge that the Federal Reserve, and other regulators of financial institutions :

(1) create effective commercial mortgage lending support to prevent "maturity defaults" and to fund the financing of new asset sales, and
(2) end "market-to-market" accounting for performing commercial real estate loans.

Hopefully, these two actions will restore confidence in the commercial real estate market quickly, because returned confidence in commercial real estate values and cash flows is critical to solving the current credit crunch.

First, the good news...in the DC area, we are doing better than the nation because of:

(1) continued employment growth as a result of the stability of the federal government, a strong private sector (working in partnership with the federal government), and strong sectors in international government and business, associations and non-profits, universities and healthcare, and entertainment and hospitality,

(2) a highly educated workforce, and

(3) a high quality of life.

Specifically in the office market, DC ended 2008 with strong performance: an average full service office rent of $51 per SF (second in the nation to Midtown Manhattan), an overall vacancy rate of 8% (third in the nation behind Midtown and Downtown Manhattan) and 2008 direct absorption of 885,000 SF of new office space (first in the nation). As a result of DC's relatively strong commercial real estate market performance in 2008 and its relatively strong outlook for 2009, AFIRE, the Association for Foreign Investors in Real Estate, ranks the DC region's commercial office market not only the strongest in the country, but also the strongest in the world. In addition, the need for additional federal workers and private contractors to handle

(1) the current national financial crisis,

(2) the recently enacted federal economic stimulus package, and

(3) the ambitious plans of the Obama Administration

has led many economists and researchers to predict that the federal government demand for space in DC and the DC area will have a positive impact on the DC and DC area commercial office real estate market.

Now, the bad news...though the city's average rent was at an all-time high at the end of 2008, rent concessions began in the last few months of 2008 and continue in 2009, and absorption in the second half of 2008 was 50% of the first half at less than 300,000 SF. The lack of predictability in capital markets and the resulting upward pressure on capitalization rates has resulted in a significant decrease in the values of commercial real estate in the city. Our estimate is that the decline in Downtown DC commercial property values during 2008 and 2009 could amount to between 25 and 40 percent.

DC is responsible for 24% of the nation's top ten cities' commercial office construction/renovation with more than 9 million SF under construction/renovation at December 30, 2008 (an increase of 7% in the city's privately-owned office stock). At the moment, only 24% of this new space is pre-leased. Assuming 50% is pre-leased upon delivery over the next two years, the city's vacancy rate will rise to 11.5%, putting downward pressure on rental rates.

The fourth quarter of 2008 and the first quarter of 2009 are the first quarters since 2001 when there has not a private office building groundbreaking in DC. The only office building groundbreaking since the second quarter is the DC government's office building for the Department of Employment Services adjacent to the Minnesota Avenue/Benning Road Metro station.

DC private leasing activity has slowed, and is focused mainly on lease renewals as organizations and businesses are reluctant to commit to the expense of moving into new space as they face a more uncertain future than usual. New quantities of sub-lease space are expected to be soon available as associations, non-profits and law firms lay off staff.

DC Office Market Performance 2001 - 2008

(all square foot numbers in millions)

Year	Average Full Service Rent Per SF	Direct Vacancy Rate	Overall Vacancy Rate	Annual Absorp-tion -- SF	Annual Leasing Activity in SF
2008	$51	7.0%	8.0%	0.9	5.2
2007	49	6	7.1	1.7	5.9
2006	44	6.3	7.3	4	7.3
2005	42	6	7.2	2.2	5.6
2004	40	5.9	7.1	2.7	7
2003	42	6.1	8	1.6	5.8
2002	42	5.4	7.9	1.4	6.5
2001	40	4.8	6.8	2.3	7.2

Source: Cushman & Wakefield

GSA, DC and the DC Area

The federal government and GSA are responsible for much of the relative strength and stability of DC's and the region's office market. The significance of GSA is shown in the following chart:

GSA Owned and Leased Space in the DC Area (a)
(all SF numbers in millions)

	DC	Sub MD	NoVA	Regional Total
Owned GSA Space	33 SF	6 SF	3 SF	42 SF
Leased GSA Space	22	11	21	54
Total GSA Space	55 SF	17 SF	24 SF	96 SF
% of Regional GSA Space	57%	18%	25%	100%
Total Office Space in Market	164 SF	46 SF	175 SF	385 SF
Total GSA Space a % of Total Market	34%	37%	14%	25%

(a) Does not include leased or owned space of non-GSA federal organizations (which includes Congress, Federal Reserve, FDIC, and Department of Defense owned facilities)
Source: GSA and Downtown BID

GSA and other federal organizations are the major source of demand for new leases. The Federal Reserve recently leased 50,000 SF in the Central Business District for the training of additional bank examiners, and the U.S. Treasury recently signed leases for 80,000 SF and 71,000 SF in two Downtown locations. The Department of Homeland Security and certain law enforcement agencies are also generating demand for new leased locations. Leasing for handling the national financial crisis, the federal stimulus package and the plans of Obama Administration will only expand GSA's presence in DC and the DC area. Because of high rents in DC's established markets ($50 to $80 per SF), GSA has overseen the move of several of its agencies to the city's emerging markets in order to minimize federal rent expenditures.

Our first recommendation is that GSA continue to commit to locating federal office space at DC area locations at Metro or with good connections to Metro as this would optimize government efficiency by locating new federal activities very close to their existing offices, minimize the environmental impact of growth, and leverage current infrastructure. GSA's leasing plays a substantial role in balancing and stabilizing the DC area economy, office market and government budget.

Our second recommendation is that GSA use the current rental market to extend current and make new leases at attractive rents. We also would point out that GSA could use the currently weak office sales market to buy office buildings and lower their agencies' building costs, but taking a large amount of privately owned properties off of the local tax rolls would have a negative impact on local governments' financial condition. We would also note that the impact of the Defense Department's Base Realignment and Closure (BRAC) decisions will lead to a substantial amount of private sector office space throughout the DC area being vacated over the next four years. We urge GSA to look at this period both as creating both an opportunity and an obligation to meet new and different federal agency needs while providing new tenants to the commercial office sector that has been a valued partner for GSA and the federal government for many decades.

Our final recommendation is that GSA continue with the policies that take advantage of existing urban and regional infrastructure, and minimize energy use and impact on the environment. Specifically, Executive Order 12072, which directs federal agencies and their agent, GSA, to give preference to downtowns and center city areas is working well for DC and the DC area. In addition, GSA's current solicitations highlight access to transit and transportation and emphasize making buildings green. We should also not lose sight of the fact that many close-in locations outside of DC also provide many of the same benefits as City locations and would be appropriate choices to further environmental and energy goals. It is clear that GSA is sensitive to these concerns. Such policies give all cities and regional growth centers a decided advantage in what is already a difficult competitive market place.

GSA's relationship with communities should not be a one-way street, in which those of us in DC or regional centers like Crystal City are asking for increased federal leasing and building activity. We see it as a two-way street, where we respond affirmatively to the needs of the federal agencies and employees. In this regard, we look forward to continuing a very productive relationship between GSA, the private sector and local governments. And, in these trying times this relationship needs to grow stronger and a hearing like this is part of that process..

Thank you for the opportunity to present this testimony to you today.