Economic Impact Statement

Montgomery County, Maryland

Expedited Bill 2-25 — Taxation – Payments in Lieu of Taxes – Affordable Housing – Amendments

SUMMARY

The Office of Legislative Oversight (OLO) anticipates that Expedited Bill 2-25 would have a positive impact on economic conditions in the County in terms of the Council's priority economic indicators. By granting a 25-year property tax exemption, the Bill would reduce operating expenses for office buildings that are converted to residential buildings and meet certain zoning and affordability requirements. All else being equal, these properties would yield higher business incomes. However, due to the significant physical and financial barriers to office-to-residential conversions and data limitations, it is unclear whether the Bill would incentivize conversions that would not otherwise occur. If this occurs, certain residents could benefit from increased access to affordable housing, potentially lowering nondiscretionary household expenses.

BACKGROUND AND PURPOSE OF EXPEDITED BILL 2-25

The County's Payment in Lieu of Taxes (PILOT) program aims "to support the construction and preservation of affordable multifamily rental housing" in the County.[1] A PILOT lowers or completely abates County real property taxes on affordable rental housing projects for a set period of time. The County offers three PILOT options. Specifically, the By Right PILOT option abates all County real property taxes for at least 15 years if:[2]

- A rental property is owned or controlled by a non-profit; and
- At least 50 percent of the units in the property are rented to households making up to 60 percent of the area median income (AMI).

The purpose of Bill 2-25 is to expand the By Right PILOT option to include commercial buildings that are converted to residential buildings. A property owner could qualify for a By Right PILOT if:[3]

- The commercial building has at least a 50 percent vacancy rate;
- The conversion of the property complies with certain zoning requirements; and
- At least 15 percent of the units in the property are affordable to households making up to 60 percent of the AMI for 25 years.

Property owners who qualify for this PILOT would be exempt from 100 percent of County real property taxes for 25 years.[4]

The Council introduced Expedited Bill 2-25, Taxation – Payments in Lieu of Taxes – Affordable Housing – Amendments, on February 4, 2025. The Bill was introduced along with Zoning Text Amendments 25-02 and 25-03 and Subdivision Regulation Amendment 25-01 as part of the "More Housing N.O.W." (New Options for Workers) package.

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[1] Payment in Lieu of Taxes (PILOT), Department of Housing and Community Affairs.
[2] Ibid.
[3] Introduction Staff Report for Expedited Bill 2-25, Montgomery County Council, introduced February 4, 2025.
[4] Ibid.

INFORMATION SOURCES, METHODOLOGIES, AND ASSUMPTIONS

As required by 2-81B of the Montgomery County Code, this Economic Impact Statement evaluates the impacts of Expedited Bill 2-25 on residents and private organizations in relation to Council's priority economic indicators. In doing so, it examines whether the Bill would have a net positive or negative impact on overall economic conditions in the County.[5]

The County would fund the Bill's 25-year property tax exemption using tax revenue. Notably, this would constitute an internal transfer from the County to property owners rather than a net increase in economic activity. As a result, the Bill's overall economic impact would depend on: (a) the annual economic effects of the tax exemption on County residents and businesses, and (b) the economic opportunity cost of the forgone County revenue. Since OLO cannot determine how the lost tax revenue would otherwise be allocated, this analysis does not assess the economic impact of alternative government spending.

To assess the Bill's economic impact statements, this analysis relies on the following information sources:

- Analyses presented by personnel from the Montgomery County Economic Development Corporation (MCEDC) and Montgomery Planning Department before the Council's ECON Committee,[6] and
- Reports on the feasibility of office-to-residential conversions by Goldman Sachs economists, Montgomery Planning analysts, and Bolan Smart Associates, a real estate consulting firm commissioned by Montgomery Planning.[7]

No formal methodologies or assumptions are used in this analysis.

VARIABLES

The primary variables that would affect the economic impacts of enacting Expedited Bill 2-25 are the following:

- Physical barriers to conversion
- Upfront costs to conversion (acquisition, conversion, financing)
- Difference between office and residential rents (per square foot)

IMPACTS

WORKFORCE ▪ TAXATION POLICY ▪ PROPERTY VALUES ▪ INCOMES ▪ OPERATING COSTS ▪ PRIVATE SECTOR CAPITAL INVESTMENT ▪ ECONOMIC DEVELOPMENT ▪ COMPETITIVENESS

Businesses, Non-Profits, Other Private Organizations

OLO anticipates that Expedited Bill 2-25 would have a positive impact on certain private organizations in the County in terms of the Council's priority economic indicators.

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[5] "Sec. 2-81B, Economic Impact Statements," Montgomery County Code.
[6] Bilal Ali, "Worksession – Office Vacancy Follow-Up" (Economic Development Committee, Montgomery County Council, March 6, 2024).
[7] Elsie Peng and Vinay Viswanathan, "The Price Is Still Too High for Office-to-Multifamily Conversion," Economic Research (Goldman Sachs, February 26, 2024); Rick Liu, "Converting Office to Residential Is Complicated," *Montgomery Planning* (blog), October 4, 2017; Bolan Smarts Associates, Inc., "Adaptive Reuse: Executive Boulevard and Rock Spring Office Markets" (Commissioned by Montgomery Planning, May 2016).

The Bill would likely impact a small portion of office properties in the County due to the physical and financial barriers to office-to-residential conversion.[8] As of Q2 2023, the County had 1,512 office buildings, with a vacancy rate of 16.5 percent—up from 11.6 percent five years earlier.[9] Based on interviews with local real estate leaders, a review of relevant literature, consultations with Montgomery County Planning, and research on local office vacancy trends, MCEDC estimated that 1 percent of office buildings, or roughly 15, are suitable for residential conversion.[10] For this reason, MCEDC designated office-to-residential conversion as a "low feasibility" solution to office vacancy in the County.

This finding aligns with analysis on the feasibility of conversions at the national level. In their February 2024 report, Goldman Sachs economists evaluated the conversion potential for "nonviable" office buildings—defined as those located in suburban areas or central business districts, built before1990, unrenovated since 2000, and with a vacancy rate above 30 percent.[11] Their analysis found that converting these buildings to multifamily housing would likely result in net losses due to high acquisition, conversion, and financing costs, combined with the typically lower rents for residential units compared to commercial properties. They conclude that "only 0.8% of US office inventory is currently priced at a level that makes conversion to multifamily housing financially feasible."

Of the approximately 15 office buildings in the County where conversion is deemed feasible, OLO cannot predict how many will pursue this option, given the significant financial barriers and risks. Some owners may instead choose lower-cost alternatives, such as renovating the property or lowering rents to attract tenants. For those who do proceed with conversion, the Bill would grant a 25-year property tax exemption if the project meets specified conditions, reducing the multifamily property's operating expenses. All else being equal, lower operating costs would increase business income for property owners.

A key question regarding the Bill's economic impact is whether it would incentivize conversions that would not otherwise occur. Addressing this question would require a case-by-case financial analysis of the buildings deemed feasible, which is beyond the scope of this report. However, OLO notes that the financial barriers to conversion may be too substantial for the tax exemption to overcome.

Beyond these potential impacts, OLO does not expect the Bill to affect private organizations in terms of the Council's other priority indicators.

Residents

OLO anticipates that Expedited Bill 2-25 could have a positive impact on certain residents in the County in terms of the Council's priority economic indicators.

As previously discussed, it is unclear whether the Bill would incentivize conversions that would not otherwise occur due to the significant physical and financial barriers to office-to-residential conversions and data limitations. If this occurs, certain residents could benefit from increased access to affordable housing, potentially lowering nondiscretionary expenses and increasing their net household income.

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[8] For discussions of the physical/architectural barriers to conversion, see Liu, "Converting Office to Residential Is Complicated"; Bolan Smarts Associates, Inc., "Adaptive Reuse."
[9] See Montgomery Planning's presentation in Ali, "Worksession – Office Vacancy Follow-Up."
[10] Economic Development Committee Worksession - Office Vacancy Follow-up, Montgomery County Government, March 6, 2024.
[11] Peng and Viswanathan, "The Price Is Still Too High for Office-to-Multifamily Conversion."

Beyond this potential impact, OLO does not expect the Bill to affect residents in terms of the Council's other priority indicators.

Net Impact

OLO anticipates that Expedited Bill 2-25 would have a positive impact on economic conditions in the County in terms of the Council's priority economic indicators. By granting a 25-year property tax exemption, the Bill would reduce operating expenses for office buildings that are converted to residential buildings and meet certain zoning and affordability requirements. All else being equal, these properties would yield higher business incomes. However, due to the significant physical and financial barriers to office-to-residential conversions and data limitations, it is unclear whether the Bill would incentivize conversions that would not otherwise occur. If this occurs, certain residents could benefit from increased access to affordable housing, potentially lowering nondiscretionary household expenses.

DISCUSSION ITEMS

Not applicable

CAVEATS

Two caveats to the economic analysis performed here should be noted. First, predicting the economic impacts of legislation is a challenging analytical endeavor due to data limitations, the multitude of causes of economic outcomes, economic shocks, uncertainty, and other factors. Second, the analysis performed here is intended to *inform* the legislative process, not determine whether the Council should enact legislation. Thus, any conclusion made in this statement does <u>not</u> represent OLO's endorsement of, or objection to, the Bill under consideration.

AUTHOR

Stephen Roblin (OLO) prepared this report.