

Summary

In 1999, Montgomery County continued to enjoy healthy and balanced growth, albeit at a somewhat faster pace than 1998. Barring major shocks to the economy, the Research & Technology Center sees no reason why these trends should not continue through 2000.

In this, the third annual update to the Economic Forces That Shape Montgomery County report, the Research & Technology Center reaches four main conclusions:

- Montgomery County's economy is very healthy.
- The current pace of growth is rapid but manageable.
- We see no evidence of the next downturn.
- This recovery is broad based and it appears most County residents have benefited.

A Very Healthy Economy

There are other local economies that are growing faster, but it would be difficult to find a county economy any healthier than Montgomery's.

Job growth is strong and the unemployment rate is at record lows. Important industries are doing well, including information technology, telecommunications, engineering, management services, hotel and lodging, and construction. The federal government saw job growth in 1998 followed a small drop in contract employees in 1999. This is a positive situation in contrast to the federal job cuts occurring during the best part of the past decade.

Federal procurement contributes up to one-third of the County's economy, and last year (FY98) procurement reached \$3.55 billion, a record high. For the fiscal year just completed, federal procurement was \$3.44 billion, just 3 percent shy of the previous year's total. Jobs at federal installations rose by 500 jobs¹, while federal leasing activity held steady at 6.6 million square feet. The federal government leases 16 percent of rentable office space in Montgomery County.

Median household income rose to \$71,930 in 1999, an increase of 2.8 percent over the year before. Because the cost of living -- as measured by the Baltimore-Washington CMSA consumer price index -- grew by just 1.7 percent, *many Montgomery County households saw real incomes grow by 1.1 percent between 1998 and 1999.*

¹ There was a net loss of contract jobs in space leased by federal agencies.

The pace of both commercial and non-residential construction increased in 1999. In 1999, Montgomery County saw the completion of 3.7 million square feet of commercial space, up from 2.6 million the year before. Much of the new space, 1.4 million square feet, was office space, almost 1 million more square feet completed in 1999 than in 1998. The pace of residential construction also increased, from 3,200 units in 1998 to more than 4,000 units in 1999.

Pace of Growth is Rapid But Manageable

Although 15,000 new jobs, 3.7 million square feet of commercial space, and 4,000+ new housing units are significant growth, the Research & Technology Center believes the pace is manageable. *Using Adequate Public Facilities Ordinance standards, the County has the public facilities in place to sustain this pace of growth for a decade or more.* It is perhaps also helpful to realize that the current pace of growth is about half that of the peak years of the 1980s.

Current Growth Well Under Peak	1999	Peak (Peak Year)
New Jobs	15,000 jobs	28,000 jobs (1985)
New Commercial Space	3.7 million s.f.	7.0 million s.f. (1987)
New Housing	4,000 units	10,000 units (1986)

No Evidence of Next Downturn

At the national level, there are always events that hint that perhaps this record recovery has run its course. As this report goes to press, the Federal Reserve has just approved another interest rate hike; stocks in general, and technology stocks in particular, recently took a tumble; and gasoline prices have soared, fueling (so to speak) concerns about inflation. But it appears that some of the money flowing out of (possibly overvalued) tech stocks is flowing into the generally-believed-to-be-undervalued Old Economy stocks and – apart from gasoline and cigarettes – retail prices have actually been flat.

At the County level, the Research & Technology Center sees the 1999 pace of growth continuing. It takes a while for the positive impact of federal procurement to make its way through the economy. We are still feeling the positive effects of two straight years of high expenditures. Our job growth figures are accelerating, not decelerating, particularly in job rich information technology, a sector where Montgomery County was lagging until 1997.

Indicators of an expanding economy are rising rents for commercial space and rising prices for houses. As both of these are continuing, it appears that the 1999 pace of delivery of new commercial and residential product were not sufficient to dampen future demand. *Based upon projects that have already broken ground, the Research & Technology Center believes that 2000 will be very similar to 1999 in terms of construction activity.*

The Recovery is Broad Based and It Appears Most Residents Have Benefited

How well have households in Montgomery County benefited from the economic health of the County has a whole. Some criteria to which we might look in judging whether County households have benefited are: Is it easier or harder to get a job? Are those jobs good ones? How quickly are incomes rising compared with the things we need to buy: housing especially, but a wide range of other items as well.

Because most industries are adding jobs, not shedding them, opportunities for workers to gain employment are as good now as they have been in a very long time. *With the unemployment rate at 1.5 percent in December, the County is at virtually full employment.*

Home prices, which had been flat for much of the decade, have begun to increase again – a positive trend for homeowners and the County’s assessable base. Prices grew by 3.6 percent in 1999 so that the median price of a single-family home is now estimated at \$212,500. However, housing affordability, as measured by the Research & Technology Center’s Housing Affordability Index, is very close to a score of “1,” which occurs when a family earning the median income can afford to buy the median-priced single-family home.

Nevertheless, challenges remain. *The poorest 20 percent of Montgomery County households have very limited housing choices and are likely to have trouble even finding a place to rent, given the very tight rental market in the County.* There is a significant supply of moderately priced housing in the County, but it is not affordable to the poorest County households.

Because most economists and social theorists believe that crime rates fall during good times, and because crime rates have fallen during these good times, the Research & Technology Center notes that *a positive impact of current economic conditions on Montgomery County residents has been an increase in public safety.* However, experts debate the extent to which the lowered crime rates can be attributed to a full-employment economy and how much can be attributed to more or better policing and the smaller number of teenagers due to the “baby bust.”

Crime is not the only indicator that would ordinarily seem to fall outside the realm of economic analysis but which shows real differences during different economic conditions. Transportation and health statistics are two others. Looking solely at so-called “purely economic” indicators misses some important trends. *At the same time, viewing all activities through a single lens – economics – colors how we interpret change. For this reason, the Research & Technology Center staff is proposing that the County pursue an expanded quality of life indicators program independent of the Economic Forces series of reports.*

Introduction

Economic Forces That Shape Montgomery County is an annual report started in the mid-1990s when there was concern about Montgomery County's slow recovery from the 1991 recession. The first report found slow growth but very healthy fundamentals. Since then, each subsequent report has found somewhat more rapid growth, whereupon last year we were able to conclude that the economy was not *still recovering*, but rather, it *had recovered*.

Year 2000 Focus

For this update, the Research & Technology Center is focusing on the specific data series in previous *Economic Forces* studies, adding additional information about the gap between available jobs and labor, and a review of how current economic trends are affecting County residents.

Last year, during the second annual *Economic Forces That Shape Montgomery County* presentation, the Planning Board asked the Research & Technology Center to look at the impact of the local economy on County residents. We have responded to this request by: 1) including a section in this year's report focusing on the economic well being of Montgomery County households and and, 2) by researching quality of life indicator programs in U.S. communities to see how they might be applied in the County.

Expected Focus 2001

For next year's *Economic Forces* report, the Research & Technology Center recommends continuing to monitor Montgomery County's economic vital signs and to explore "spinning off" the measures of economic well being into a full-fledged quality of life indicators program. The Research & Technology Center's discussion of a possible quality of life indicators program continues in a separate document.

A specific request of the Department of Economic Development – and one that has been echoed by others – is that the Research & Technology Center should complete an in-depth report on the information technology and telecommunications industries, similar to the forthcoming biotechnology industry report. They point out that there are over 25,000 information technology jobs and over 10,000 telecommunications jobs in Montgomery County and that those two industries have recently been growing at double-digit rates in Montgomery County. That's quite a lot of activity for a sector that people generally associate with other parts of the country, and the Research & Technology Center believes it would be useful both to showcase and to better understand these industries.

The Economic Forces Series

The *Economic Forces* studies seek to support the Montgomery County Council's economic analysis needs, particularly during preparation of the budget and when evaluating economic development initiatives or regulatory proposals. To accomplish this, the Research & Technology Center works closely with the Department of Finance and the Department of Economic Development, relying upon them for guidance in identifying economic trends and for suggestions on how to improve the usefulness of the report. Such collaboration helps eliminate duplication of effort while helping to assure that even though opinions may differ, the information underlying those opinions is consistent and valid.

Possibly the major value of each *Economic Forces* update is that a review of the trends indicates issues that deserve more in-depth study. In the past, such studies have included a study of Class B & C office space, a commercial sites characteristics inventory, an upcoming in-depth look at Montgomery County's biotechnology industry, and an upcoming housing study.

Developing the in-house expertise required to complete the *Economic Forces* update has strengthened the Research & Technology Center's ability to support master plan development and to respond quickly and thoroughly when policy questions arise, such as last fall's Annual Growth Policy debate and this spring's review of how the Moderately-Priced Dwelling Unit Ordinance is working in Central Business Districts.

1999 Conclusions

Last year, when the Planning Board reviewed the *Economic Forces That Shape Montgomery County* study, the Board developed five conclusions based upon what they'd read and heard:

- Yes...Montgomery County has recovered from the recession.
- Our economic growth is healthy and balanced.
- The pace of growth is appropriate and manageable.
- Growth is occurring in the right places.
- We have a large inventory of good sites to meet job growth needs.

Each of those conclusions applies this year as well, which is why this year's conclusions seem very familiar. One other conclusion reached by the Planning Board last year was a request that staff spend some additional time looking at how current economic trends are affecting Montgomery County residents. A number of these indicators are included in this report for the first time. With the assistance of outside experts, Research & Technology Center staff collaborated with staff from County agencies, the bi-county and Prince George's County branches of the M-NCPPC tree, and Montgomery County Park and Planning employees from several divisions to explore the advisability of expanding from purely economic indicators to those encompassing quality of life in general.

Part 1: Job Growth

Montgomery County added 14,923 jobs between the first quarters of 1998 and 1999 for a growth rate of 3.7 percent. That compares to 13,000 new jobs -- a 3.1 percent growth rate -- added the previous year. This is the largest annual increase of jobs in the 1990s and is the third straight year of healthy job growth.

Private sector jobs grew by 13,064, or 4.0 percent. Private sector job growth was led by growth in the services sector -- almost 9,000 jobs, or about 70 percent of the private sector job growth, were in services. The services sector is a broad one, comprising a wide spectrum of employment categories from software programmers to architects to building maintenance staff to barbers. The two other major private sectors contributing large numbers of new jobs were the construction industry (1,572 new jobs) and the Finance, Insurance and Real Estate industry (1,690 new jobs).

Public sector -- government -- jobs grew by a much slower 2.5 percent. The federal government began adding jobs between the first quarters of 1998 and 1999. Job growth leveled off during 1999 but is expected to increase in the near future. The federal government's jobs are well paying (in the range of \$60,000+ per year on average) so the gradual but continuous loss of these jobs over the past decade has been a drain on the County economy. The County's very small number of state employees became even fewer: state jobs fell from 1,244 to 1,074 between the first quarters of 1998 and 1999.

The High Tech Sectors

Montgomery County's high technology industries -- aerospace, biotechnology, information technology, and telecommunications -- are adding jobs almost twice as fast as the economy as a whole. High tech jobs grew 7.0 percent between the first quarters of 1998 and 1999, while the growth rate for all sectors was 3.7 percent. There are now over 63,000 private sector high tech jobs in Montgomery County, which is 15 percent of all County jobs.

That number (63,000) does not include the many public sector high tech jobs in Montgomery County, including those at federal installations such as the National Institutes for Health, the National Institute for Standards and Technology, and the Department of Energy.

Montgomery County's 7.0 percent growth rate for high tech jobs outpaces the 4.9 percent growth rate for the State of Maryland, and the 3.0 percent growth rate for the nation.

For much of the 1990s, the information technology sector was generating large numbers of new jobs in other localities but experienced lackluster performance in

Montgomery County. That's no longer the case. Infotech's turnaround began in the final months of 1996 and growth in this sector has been accelerating ever since. Last year we reported a 10 percent growth in information technology jobs; this year the pace has picked up to 14.4 percent. As of the first quarter of 1999, there were about 25,400 information technology jobs in Montgomery County.

The County's 14.4 percent growth rate for infotech jobs compares favorably with the 10.5 percent growth rate for the state of Maryland and the 5.3 percent growth rate for the nation.

A signature industry of Montgomery County is biotechnology, which is the subject of a special in-depth report being released this spring. We are not including state job growth data for the biotechnology industry this year because of some data anomalies we are still exploring.

Montgomery County's aerospace industry has about 16,000 jobs and is growing at a 4.2 percent rate, just slightly ahead of the state's 4.5 percent growth rate but well ahead of the nation's 1.6 percent growth rate. In a few years, the County will return to its 1989 peak in aerospace jobs if the solid growth experienced in the past few years continues.

Telecommunications was a high-growth sector for Montgomery County in the early 1990s, a period when few other sectors were adding many jobs. Beginning in 1994, however, growth stalled, and the industry has been adding or losing a small number of jobs each year since. More recently, this sector has been "trending up," with job growth a solid 3.5 percent between 1998 and 1999. That rate is more than three times the state rate of 1.0 percent, and well above the national rate of 2.1 percent.

Other Top Performing Sectors

As mentioned earlier, the "services" sector is both Montgomery County's largest sector as well as the one adding the most jobs. The services sector includes a large number of industries, from amusement and recreation services to auto repair to hotels to computer and data processing.

One major subset of the services sector is "business services," which encompasses computer and data processing, advertising, personnel, mail and reproduction, and services to buildings. Because it includes sectors that literally "serve businesses," growth in this sector is a good indicator of economic strength.

Montgomery County's business services sector grew 8.6 percent between the first quarters of 1998 and 1999, compared with 6.2 percent for the U.S. and 4.3 percent for the state. There are now over 53,000 business services jobs in the County.

Engineering and management services is a sector that includes engineers, architects, accountants, and management consultants and is Montgomery County's third largest -- and second fastest growing -- industry. Jobs in this sector grew by 4.7 percent to

31,500. Engineering and management services jobs pay an average of \$53,000. There are over 2,700 engineering and management services firms in Montgomery County.

If Montgomery County can have a second signature industry, it would be the hotel and lodging industry because we are home to the headquarters of two of the major hotel chains, Marriott and Choice. For that reason, average wages in this industry are very high: over \$70,000 (the average wage of a job located in Montgomery County is \$40,508). Hotel and lodging jobs jumped by 18.4 percent in 1999. The hotel and lodging industry employs about 8,400 in Montgomery County at 66 establishments.

The increase in the pace of construction is reflected in an increase in the number of construction jobs. As mentioned, the construction industry overall added 1,572 jobs between the first quarters of 1998 and 1999. The majority of those new jobs were in two sectors: special trade contractors and general building contractors. Together, these two sectors added 1,426 jobs for a growth rate of 7.3 percent. The average wage in these two sectors -- \$39,696 -- is almost identical to the average wage for County job in any industry: \$40,508. There are just under 21,000 contractor jobs in Montgomery County working for 2,251 firms.

Jobs at nondepository institutions (mortgage bankers and personal credit institutions) jumped 25 percent between 1998 and 1999. Although the sector is not huge (it is Montgomery County's 30th largest industry and has about 3,500 jobs in the County), that pace makes it one of the fastest-growing. The average wage of a job in that sector is \$64,480.

A small but rapidly-growing and high-paying sector is securities and commodities brokers. This has been true for the past several years. Currently, the industry has 2,854 jobs in the County and is adding jobs at a rate of 20 percent per year. The average wage in this industry, \$126,568, is three times the County average.

Job Growth Preview

As in previous *Economic Forces* studies, most available data is a year old by the time it is included in the study. The *Economic Forces* study relies on data from the Maryland Department of Labor Licensing and Regulation, which has a nine-month lag. The additional three-month lag allows RESI at Towson University to analyze the data and report it to the Research & Technology Center.

Part 2: Federal Impact

The federal government plays three very important roles in Montgomery County's economy: it is an *employer*, it is a *tenant* and *landowner*, and it is a purchaser of goods and services.

As an employer, the federal government is a major source of income for Montgomery County residents and workers in the County. During Fiscal Year 1998, the federal government paid workers in the County \$2.6 billion in wages and salaries. It also paid County residents \$2.3 billion in direct payments to individuals for retirement and other benefit programs.

Employment levels are reasonably stable. According to a survey of 12 federal agencies, jobs in federally-owned and leased space dropped by 900 from February 1999 (57,600 jobs) to January 2000 (56,700 jobs), a 1.6 percent decline. Most of the decline was due to a reduction in the number of contract workers in federal agencies rather than a decline in direct federal employment. Collectively, the agencies surveyed anticipate current job levels to continue through 2005 and then anticipate job increases of 3.4 percent between 2005 and 2015 when workers at these agencies will number about 58,600.

Given the federal policy of shifting workers from leased space to owned space, workers at federally owned space are expected to increase by 12,100 between 2000 and 2015, and workers in federally leased space are expected to decline by 10,200. The main shift from leased to owned space will be the Food and Drug Administration's consolidation at their facility in White Oak.

Federally Leased Space

Federally leased space has remained unchanged since February 1999. *The General Services Administration (GSA) leases 6.6 million square feet of space in Montgomery County, about 16 percent of the County's existing rentable office space.* Over half of this space, 66 percent or 4.4 million square feet, is leased by the Department of Health and Human Services. The Department of Commerce is the only other agency leasing more than 1 million square feet. Its 1.2 million square feet of leased space is 18 percent of GSA's inventory in the County.

Over half of GSA's leased space is in the Rockville area, which includes most of North Bethesda. GSA leases 3.6 million square feet of space in the Rockville area, 54 percent of their County inventory. Two other areas have over 1 million square feet of

GSA leased space: Silver Spring has 1.2 million square feet (19 percent) and Bethesda has 1 million square feet (16 percent).

Federal Procurement

Fiscal Year 1999's \$3.44 billion procurement spending in the County is just below last year's all time high of \$3.55 billion, a drop of 3.4 percent². It is the County's second highest total. During the same period, federal procurement rose by 3.5 percent in the Washington Area and by 1 percent nationally. *Over the past ten years, the County's federal procurement increased at a respectable annual compound growth rate of 6 percent, though lower than the Washington Area's annual compound growth rate of 7.4 percent.* During most of the 1990s, about two-thirds of the Washington Area's procurement growth has gone to Northern Virginia. The trend has been to shift procurement dollars from purchasing products and research and development activities to purchasing services. Northern Virginia had an established information technology base, located near major defense installations, that was well positioned to capitalize on this shift in procurement purchasing.

The Departments of Defense and Health and Human Services are the source of over half the procurement dollars spent in the County. The Department of Defense spent \$1.1 billion, 33 percent of total procurement, and Health and Human Services spent \$894 million, 26 percent. But both agencies spent fewer procurement dollars in FY99 than FY98. The Department of Defense spent \$57 million less, a drop of 5 percent, and Health and Human Services spent \$35 million less, a drop of 4 percent. The biggest gain in procurement was by the Justice Department, up \$136 million, more than double the previous year's spending. The biggest loss in procurement was by the Department of Transportation. During the past year their spending dropped by one-third, or by \$138 million.

More than half the federal procurement spent in the County in FY99 was spent on Business Services, 31 percent or \$1.1 billion, and Engineering and Management Services, 26 percent or \$885 million. Almost 90 percent of the Business Service procurement was spent on computer related services, such as systems design, facilities management, data processing, and programming services. Almost 80 percent of the Engineering and Management Services procurement was spent on management services, engineering services, commercial physical research, and management consulting services.

² Federal procurement totals for a given year tend to increase over time as additional contracts are reported. For example, the total for FY98 has risen to \$3.78 billion a year later. This analysis uses the totals available in February or March for each year so that the data will be comparable.

Part 3: Commercial Space

Montgomery County's real estate cycle has been in its expansion phase since mid-1997. The expansion followed a long recession and recovery period from late 1990 through late 1996. The expansion started with renovation of Bethesda's Fairmont Office Building, completed in mid-1997, and soon spread to construction of new office, flex, and industrial space. Falling vacancy rates and rising rents up through the present (March 2000) indicate that the expansion is continuing.

The expansion is broad based. All classes of office, flex and industrial space have shared in the increased occupancy levels and rising rental rates. *Average Class A office asking rental rates in the County have increased from \$20.66 to \$27.14 per square foot since July 1997. Class A vacancy rates have fallen from over 6 percent to about 4 percent. These changes indicate that the expansion is strengthening.*

We monitor changes to these indicators regularly, watching for signs that the expansion is ending and the commercial real estate market is moving into the oversupply phase. The first indication of oversupply should be increases in the Class A vacancy rate above 5 percent and new space that is not rapidly absorbed. This would be followed by a persistent decline in rental rates. Our subscription to the CoStar database allows us check these numbers every two weeks.

All major jurisdictions have participated in the expansion. Even those who have lagged behind, such as Prince George's County, have benefited from substantial declines in their vacancy rates.

We see this expansion continuing for the next year or more. New 1999 preliminary plans of subdivision total over 4 million square feet. These new approvals more than made up for the over 3.5 million square feet of completions last year. The pipeline remains over 36 million square feet. Anecdotal evidence indicates that tenants are searching hard to find suitable new space.

Part 4: Labor Force Profile

In the first *Economic Forces That Shape Montgomery County* study, the Research & Technology center used 1990 Census data to perform an in-depth review and comparison of the labor forces of Montgomery, Fairfax, Frederick, and Prince George's Counties. An update of that study is not possible until the 2000 Census data are available in a few years.

For this report, the Research & Technology Center is providing conclusions about labor force trends gleaned from the 1997 Census Update Survey. The Research & Technology Center executes a Census Update Survey twice a decade (in years ending in 4 and 7) to gather detailed information about Montgomery County residents. Because other localities do not do comparable surveys, it is not possible to compare Census Update Survey findings with data from other jurisdictions.

The Research & Technology Center offers three basic conclusions about labor force trends in the next few years:

- *The jobs/labor force gap (also known as the "labor force shortage") will continue.*
- *The number of mature workers will increase, but the number of younger workers will not.*
- *Immigrants, who will continue to be an essential source of labor in all categories, will partially mitigate the jobs/labor force gap.*

The jobs/labor force gap will continue over the next 20 years because the number of jobs created will exceed the number of County residents joining the labor force. This trend reflects Montgomery County's growing status as a maturing county and as a job center.

The jobs/labor force gap is exacerbated by long-term demographic trends, principally the aging of the baby boom and baby bust generations. Looking nationally, the one age cohort expected to lose population between now and 2010 is the 30-44 age group. A similar trend will occur in Montgomery County, although the situation is not nearly as severe. Between now and 2005 the number of persons aged 15-24 will edge up (from 55,000 to 60,000) and the number of 25 to 39 years olds edge down (from 177,000 to 176,000), but the number of "mature workers" age 40 and above will increase from 258,000 to 286,000.

The gap between jobs and labor is partially mitigated by immigration, and the Research & Technology Center expects the County's high levels of foreign immigration to continue. Immigration trends are shaped primarily by two factors: federal policies and past immigration. Assuming federal policies do not change, immigrants tend to locate in

areas that have already welcomed substantial numbers of immigrants in the past. Montgomery County has been successful in attracting immigrants from many different countries and this will continue.

Apart from sheer numbers (over 9,500 foreign immigrants came to Montgomery County in FY96), immigrants are, on average, younger than the resident population. Immigrants therefore help mitigate the aging of the labor force that would occur if Montgomery County relied on the resident labor force alone.

Immigrants bring a variety of skills to the County labor force. On average, Montgomery County's foreign-born residents are more likely than native-born residents to have a Ph.D (10 percent to 6 percent).