Economic Forces That Shape Montgomery County

Annual Update 2001

March 2001

Produced by

Research & Technology Center
Montgomery County Department of Park and Planning
Maryland-National Capital Park and Planning Commission

with

RESI Research & Consulting
Towson University

THE MARYLAND-NATIONAL CAPITAL PARK & PLANNING COMMISSION

The Maryland-National Capital Park & Planning Commission is a bi-county agency created by the General Assembly of Maryland in 1927. The Commission's geographic authority covers most of Montgomery and Prince George's counties. The Commission's planning jurisdiction, the Maryland-Washington Regional District, comprises 1,001 square miles; its parks jurisdiction, the Metropolitan District, comprises 919 square miles.

The Commission has three major functions:

(1) The preparation, adoption, and, from time to time, amendment or extension of The General Plan (On Wedges and Corridors) for the Physical Development of the Maryland-Washington Regional District Within Montgomery and Prince George's Counties.

(2) The acquisition, development, operation and maintenance of a public park system.

(3) In Prince George's County only, the operation of the entire County public recreation program.

The Commission operates in each county through a Planning Board appointed by and responsible to the county government. The Planning Boards are responsible for preparation of all local master plans, recommendations on zoning amendments, administration of subdivision regulations, and general administrations of parks.

The Maryland-National Capital Park & Planning Commission encourages the involvement and participation of individuals with disabilities, and its facilities are accessible. For assistance with special needs (e.g., large print materials, listening devices, sign language interpretation, etc.), please contact the Community Relations Office, 301-495-4600 or TDD 301-495-1331.

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Economic Forces That Shape Montgomery County Annual Update 2001

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Part I: Introduction

The year 2000 was one of the most economically successful in Montgomery County's history. The number of jobs in the County increased by more than 20,000 in the year between the second quarter of 1999 and the second quarter of 2000. This is below the County's record of 28,000 jobs in one year recorded in 1985, but well ahead of the 6,800-job-per year average of the 1990s. Montgomery County's high-tech sectors added jobs at a 12 percent rate, well ahead of the state and the nation. There are now 78,000 high technology jobs in Montgomery County.

The Federal government plays several important roles in the County economy. In 2000, the news from the Federal government was positive. Federal procurement of County goods and services rose to $3.8 billion, a record. Federal agencies located in the County added workers and revised upward their forecasts for future employment.

The commercial space market continued to expand in 2000, with vacancy rates remaining low even as new buildings come on line. Rents commanded by County buildings continued to increase, and there is strong pre-leasing activity for yet-to-be-completed office buildings.

The strong economy affected residents in several ways, both positive and negative. Among the positives: the strong job market meant that a very small proportion of the County's labor force (just 8,600 persons) is out of work. Real incomes that is, adjusted for inflation -- rose slightly to $73,980 for the median household. Crime rates fell by 15 percent. Home values rose in 2000, resulting in a decline in the affordability of single-family homes. Apartments were also less affordable, as very low vacancy rates spurred rent increases that averaged almost 8 percent.

Although much of the local economic news was positive in 2000, the national outlook became increasingly cloudy as the year progressed. The sharp declines in the stock market were joined by announcements of layoffs, lowered corporate profits, and a dropoff in consumer confidence. As evidence of a pending national recession grew during the beginning of 2001, the Research & Technology staff began work on this, the third update to *Economic Forces That Shape Montgomery County*. For that reason, we decided that the focus of this report would be on the prospects for the local economy in the face of a national slowdown.

We approached this in two ways. First, we made a special effort to review the data series we track for this study with an eye toward distilling out the leading indicators – those that might indicate a change in the course of the County economy over the next year. Second, we asked our longtime partners on previous *Economic Forces* studies – RESI Research & Consulting at Towson State University – to do a special report focus on the County's economy. We are very pleased with both their finding – that the most likely scenario for the County in 2001 is a mild slowdown but continued growth – and the quality of their report, which is included as Part II.

Part III of the report contains a summary of Research and Technology Center analysis of the four areas covered in each Economic Forces study: job growth, federal impact, commercial space market, and measure of well-being. The text is followed by a graphical review of those indicators. Appendix 1 and 2 contain detailed job growth and federal impact statistics.

About ***Economic Forces That Shape Montgomery County***

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 very healthy, growing at a rapid but manageable pace.

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, a just-completed 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 debates on the Annual Growth Policy, affordable housing, elderly housing, and other issues.

At the request of the Department of Economic Development – a request that has been echoed by others – the Research & Technology Center is completing an in-depth report on the information technology and telecommunications industries, similar to the last year's biotechnology industry report. 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 the forthcoming report will be useful both to showcase and to better understand these industries.

Part II: Special Focus 2001

Prospects for Montgomery County's Economy in a Time of National Economic Slowdown

Analysis by RESI Research & Consulting, Towson University
Anirban Basu, Principal Author
Dana Hawkins, Contributing Author and Researcher
Brittany Keller, Contributing Author and Research

Introduction: Montgomery County Economic Slowdown to be Mild and of Limited Duration

The world would be considerably more economist-friendly if one could neatly segment the U.S. economy into two component parts. The first part would include financial markets, the second the underlying or real economy. Financial market prediction would remain difficult if not impossible, but at least economists would not have to factor in the wild vicissitudes of stock prices into their predictions of the real economy, and could focus on more mundane aspects of economic life such as inventories, interest rates and incomes.

Alas, the world is as it is, and the real economy is inextricably linked to financial market performance and vice versa. As a result, predicting the economy this year is particularly treacherous for the client-serving economist concerned with reputation. Consequently, RESI has approached this task by compiling substantial amounts of information pertaining to the interaction between financial markets and the real economy. The conclusion one reaches is that a bear market does not necessarily imply a recession, but that the ongoing market correction is having a measured impact on the real economy that is bringing the nation closer to economic recession than many economists had considered likely. Still, RESI maintains the view that the nation will barely avoid recession this year, and will experience an uptick in economic performance by the fourth quarter of 2001, perhaps sooner if the Federal Reserve begins to respond to economic uncertainty more aggressively than has been the case through mid-March.

RESI's task is further complicated by the fact that the economies of the nation, Maryland and Montgomery County are related somewhat loosely in their performance over time due to the uncommon structure of Montgomery County's economy. With an economy disproportionately driven by federal activities and technology, and with a residential base that is considerably more affluent than the balance of the nation and the state, Montgomery County will perform substantially differently than larger territorial agglomerations.

In particular, there are three reasons to believe that Montgomery County will respond more favorably to economic slowdown than the balance of the nation. First, as a wealthy county, the typical Montgomery County resident is more likely to benefit from a substantial savings buffer that protects them from economic adversity. With this buffer in place, Montgomery County residents on average are less likely to dramatically curtail their spending behavior than their counterparts elsewhere in the nation. Less well-heeled consumers are more likely to live from check to check, and during times of growing economic uncertainty, may feel the need to rapidly create savings buffers that can create several weeks of breathing space. As a result, consumer confidence in less affluent communities is likely to fall more precipitously during periods of economic turmoil, and result in relatively more rapid reductions in household spending.

Second, because of its relationship to federal agencies, Montgomery County's economy is less subject to economic cycles than is the balance of the nation. This may strike students of Montgomery County's near-term history as somewhat counterintuitive given the performance of the county's economy during the early 1990s. At that time, Montgomery County's substantial reliance on the federal government led to an exaggeration of the impacts of the business cycle, as federal layoffs and cuts in defense and other forms of federal procurement aggravated an already softening economy. The dynamics of the early 1990s do not appear to be in place today, and recent federal spending announcements (e.g., NIH) suggest that this aspect of the county's economic composition will serve as a partial shield from current economic conditions.

Third, much of the weakness in the national economy has been in manufacturing, including in autos and apparel. Traditional manufacturing does not play a major role in the performance of Montgomery County's economy, and to the extent that manufacturing is present in the economy, much of it relates to federal procurement, and is therefore not particularly exposed to the gyrations of the underlying economy.

It is true that there are also factors that construed in isolation suggest that Montgomery County's downturn may be worse than that which will be experienced in the balance of the nation. First, technology companies have been particularly hard hit since the current slowdown began to take shape during the first half of 2000. As a technology-intensive economy, one would conclude that Montgomery County's exposure to the downturn is substantial. Indeed, a studied look at recent layoff announcements among county businesses shows that a significant proportion of layoffs is taking place in the county's tech sector.

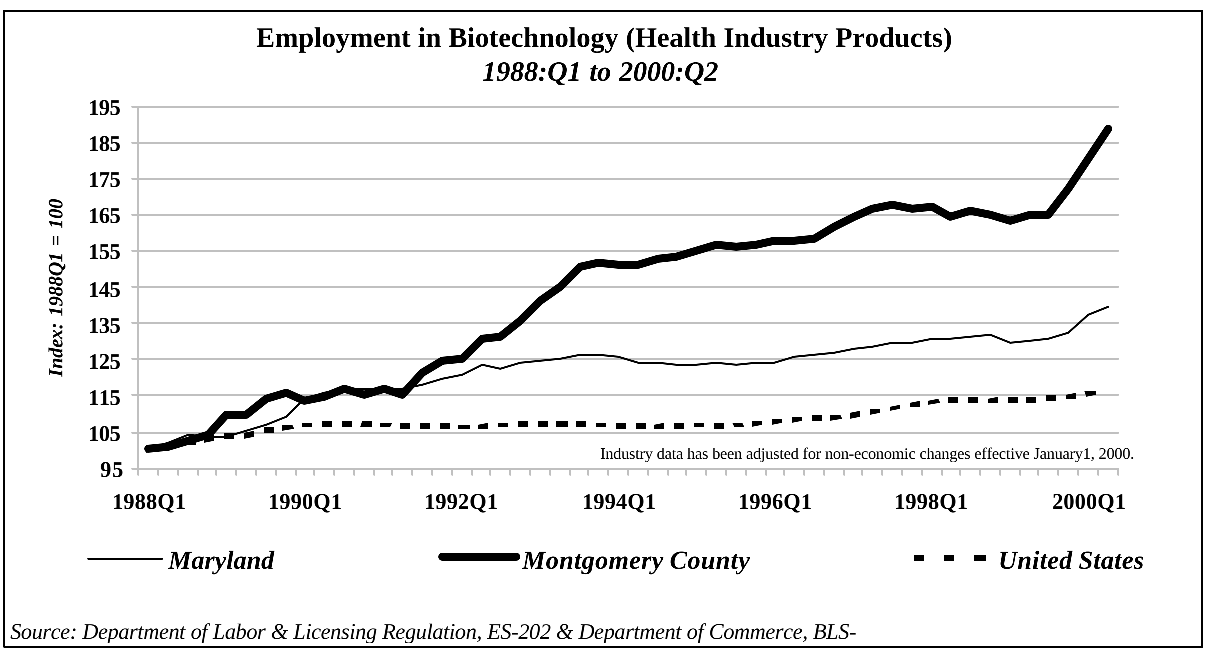
However, less attention has been paid in the media and generally to the fact that there are technology companies that continue to expand in Montgomery County, particularly within the rejuvenated biotech sector. Until last year, young biotech companies had been largely overlooked by the venture capital community, which remained enamored by Internet start-ups. The collapse of the dot-com sector has helped to reverse the financial calculus, and biotech companies are now positioned as the primary focus of attention. As a result, biotech is expanding even as Internet start-ups

collapse, and Montgomery County continues to experience growth in its technology sector. Still, this growth is unlikely to be as robust in the coming year as was the case during the late 1990s, and Montgomery County can expect to experience diminished activity in office absorption
and construction starts in the near-term.

Selected Recent Layoffs in Montgomery County

Firm	Type of Firm	Number of Jobs Cut	% of Firm's Montgomery County-based Employees Cut
Ace-Comm Corp.	Software Manufacturer	27	15%
SpaceWorks Inc.	E-commerce Software Retailer	70	25%
Iconixx Corp.	Web site Development and Consulting	100	18%
AtYourBusiness.com	Small Business Mgmt. Services	8	17%
Discovery Communications, Inc.	Cable Television Company	230	40%
USLaw.com	Web-based Provider of Legal Services	25	52%
Startec Global Communications Corp.	Int'l Telephone Service Provider	90	19%
Choice Hotels International Inc.	Hotel Management	40	9%
Spotcast Communications	Cellular Advertising Transmission	up to 40	up to 100%
Invitrogen Corp.	Provides Tool and Services for Biotech	75	5%
Capital.com	Online Financing and Capital Market	25	100%
MillionEyes.com	Provider of Free Internet Service	15	N/A

Recent layoff announcements among county businesses shows that a significant proportion of layoffs is taking place in the county's tech sector. However, less attention has been paid in the media and generally to the fact that there are technology companies that continue to expand in Montgomery County, particularly within the rejuvenated biotech sector.



Biotech is expanding even as Internet start-ups collapse, and Montgomery County continues to experience growth in its technology sector.

Another adverse factor is, ironically, related to one of the county's greatest strengths. Because of its immensely wealthy resident base, Montgomery County residents have likely been more heavily impacted by the downturn in financial markets, and therefore the county has experienced higher levels of wealth destruction than is true almost anywhere else. Though this diminution in wealth is unlikely to have a major impact on day-to-day spending decisions, the loss of wealth will have an impact on longer-term spending commitments, including on housing and automobiles.

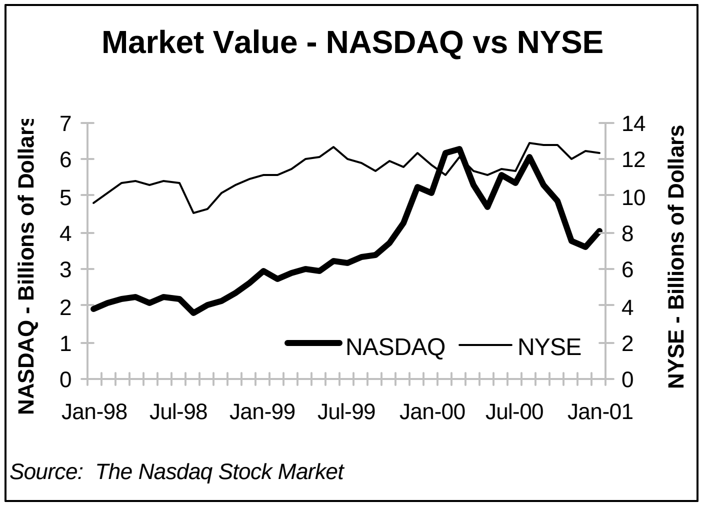
Taken in its entirety, the outlook associated with the most likely scenario is for a softer Montgomery County economy during the first three quarters of 2001 than was the case in 1998, 1999 and even 2000. The Federal Reserve has not been particularly aggressive in heading off the national economic downturn, and as a result the second and third quarters of 2001 are not likely to be good ones for the U.S. economy. Thereafter, the economy should strengthen. As of the writing of this article, the Federal Reserve has cut the Fed Funds Rate target by 1.5 percent since 2001 began. The target now stands at 5 percent. The impact of these Fed actions will begin to manifest themselves by Fall 2001, setting the stage for a fourth quarter rebound in consumer sentiment and spending. RESI anticipates that a nascent rebound in financial markets will have already begun by that point, and that the March/April period of 2001 will represent the nadir of the current financial cycle.

For Montgomery County, this will mean that the middle of 2001 is likely to be relatively soft, though the county will fair considerably better than the nation as a whole and will not face anything resembling a true recession. Indeed, the most likely scenario is for the county's economy to experience what was experienced in 1995, a time of non-recessionary slowdown that was followed by several years of robust economic performance. With interest rates remaining low in the face of controlled inflation, and with its concentrated locus of technology firms, Montgomery County is likely to be a superb performer during the next technology segment rebound. Whether tech's rebound begins in 2002 or sometime thereafter is anyone's guess, but the county's long-term outlook has not in any way been diminished by near-term events, events that will remain far from cataclysmic.

Part 1 – The Economy Thus Far

A. The Economy of the United States – Will Barely Miss Recession

Stock prices are collapsing. Since peaking in March 2000, roughly $4 trillion in shareholder wealth has been destroyed, representing a decline exceeding 25 percent. After a steady tumble from grace, the Nasdaq slipped below 2000 on March 12 and is now off approximately 60 percent off its 5,000+ peak. The broader market is also hemorrhaging. The S&P 500 index is off 20 percent, placing it squarely in the grasp of the bear.



The tightest link between financial market performance and the real economy is through the wealth effect, which during bull markets, has a positive impact on consumer confidence and spending, but now, has the exact opposite effect. Since peaking in March 2000, roughly $4 trillion in shareholder wealth has been destroyed, a decline of 25 percent.

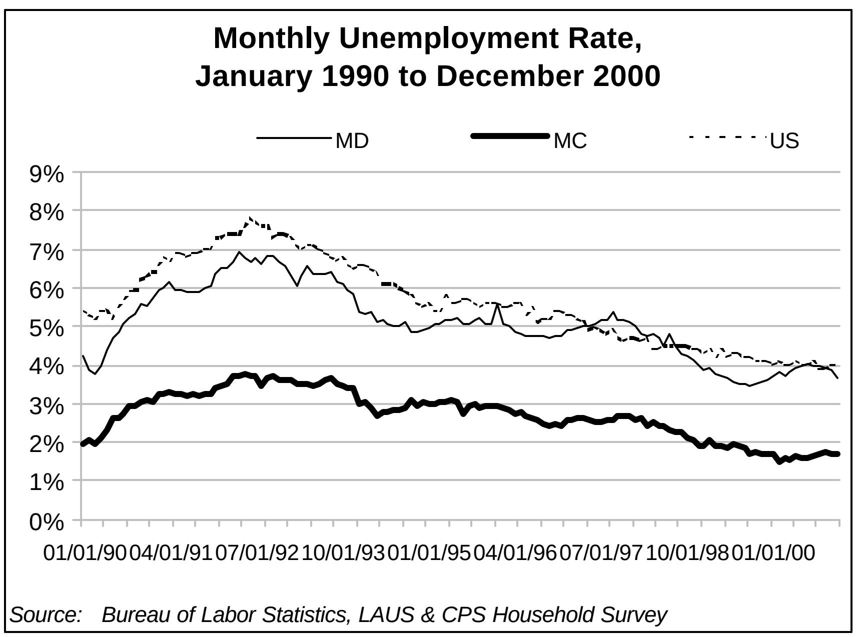
The tightest link between financial market performance and the real economy is through the wealth effect, which during bull markets, has a positive impact on consumer confidence and spending, but now, has the exact opposite effect. Most analysts are quick to note that consumer confidence hit an all-time high at nearly precisely the moment that the stock market was peaking last year. That the relationship between consumer confidence and financial market performance is so tight comes as little surprise. When financial markets are performing well, consumers are able to leverage assets by borrowing more liberally and reap increasing amounts of cash from accumulated capital gains. Realizations rose from $135 billion in 1994 to a whopping $550 billion in 2000.

Crashing stock prices have reversed this dynamic, and national retail sales have gone from expanding at a double-digit pace one year ago to a low single-digit growth rate most recently. Since two-thirds of overall economic growth is driven by consumer spending, the impact of crashing stock prices has already begun to be intensely felt on the underlying real economy. Indeed, in February 2001, retail sales declined 0.2 percent, sharply below expectations of modest growth. The report indicated that plunging consumer confidence may be translating into more pronounced consumer retrenchment, and a recent spate of layoff announcements coupled with persistently high energy prices are likely to further erode consumer confidence going forward. A recent report stating that the net worth of American households declined in 2000 for the first time in 55 years merely buttresses these concerns.

Another factor affecting consumers is their heavy debt burden, something they were willing (and able) to overlook when the economy was soaring and their portfolios flying Icarus-like toward the heavens, but now that the NASDAQ and other financial markets find themselves submerged and the economy appears headed in a new and less preferred direction, consumers are beginning to face up to their debt demons. The household debt service burden has now hit 13.7 percent, the highest it has been since the late 1980s and near the historic high reached during the mid-1980s. This high debt burden is resulting in a reduction in the amount of credit available to consumers as lenders begin to tighten in order to limit potential loan losses. Creditors have reason to be worried. Personal bankruptcy filings are rising nationally for the first time in over two years.

Layoffs have jumped from just over 44,000 in November to 134,000 in December, 142,000 in January and 102,000 in February. Moreover, the layoffs are beginning to hit large technology and related companies, not just small ones. Gateway, Nortel Networks and CNN News Group together laid off over 10,000 workers in one mid-January week. Help wanted advertising in newspapers is at its lowest point since 1995 representing a decline in employer hiring intentions. The share of consumers expecting fewer job opportunities in the next six months is now greater than the share anticipating increasing employment openings, a statistic that correlates heavily to consumer confidence.

All this makes it quite surprising that the most important labor market indicator of all, the unemployment rate, has hardly budged. The jobless rate has remained around 4 percent for all of 2000, largely because prospective workers are now more reluctant to jump into the labor force given the less welcoming environment. The low unemployment rate should keep consumer spending from slipping too far even as consumer confidence plummets. Personal income growth, a key but often overlooked statistic during times of financial market ruin, rose 0.6 percent in January, a rate of growth consistent with continued economic growth.



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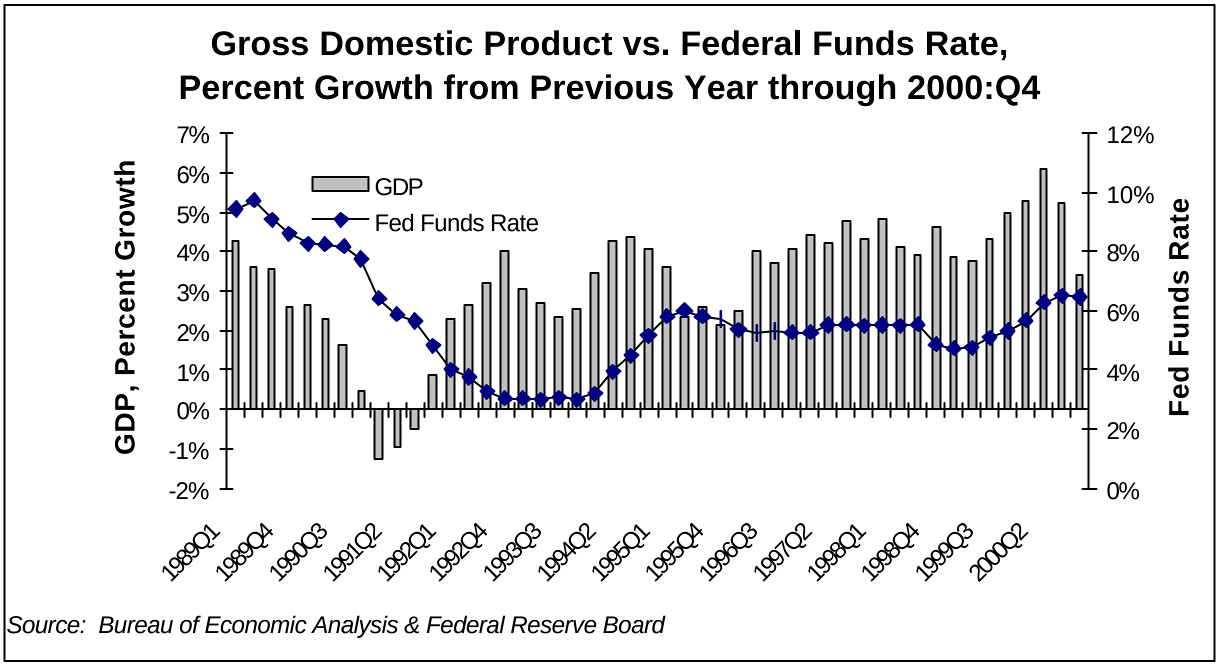
102,000 in February, employer hiring intentions are declining

The Federal Reserve's improving monetary stance should keep job growth from slipping too much further, or alternatively, should allow job growth to resume a more advanced pace by late-2001. Job growth has remained remarkably steady despite the collapsing stock market. In February 2001, national job totals were 1.3 percent higher than they were one year ago. The year-over-year rate is highly suggestive of the view that the economy remains above recessionary waters. Job growth has slid gradually slower since mid-year 2000. In July 2000, for instance, annual job growth was hovering above 2 percent.



Recent economic fluctuations suggest that the lag between Federal Reserve tightening and loosening of monetary policy and the economy's response ranges between three and four quarters. If history holds true to form, the U.S. economy should begin to improve by the fourth quarter of 2001.

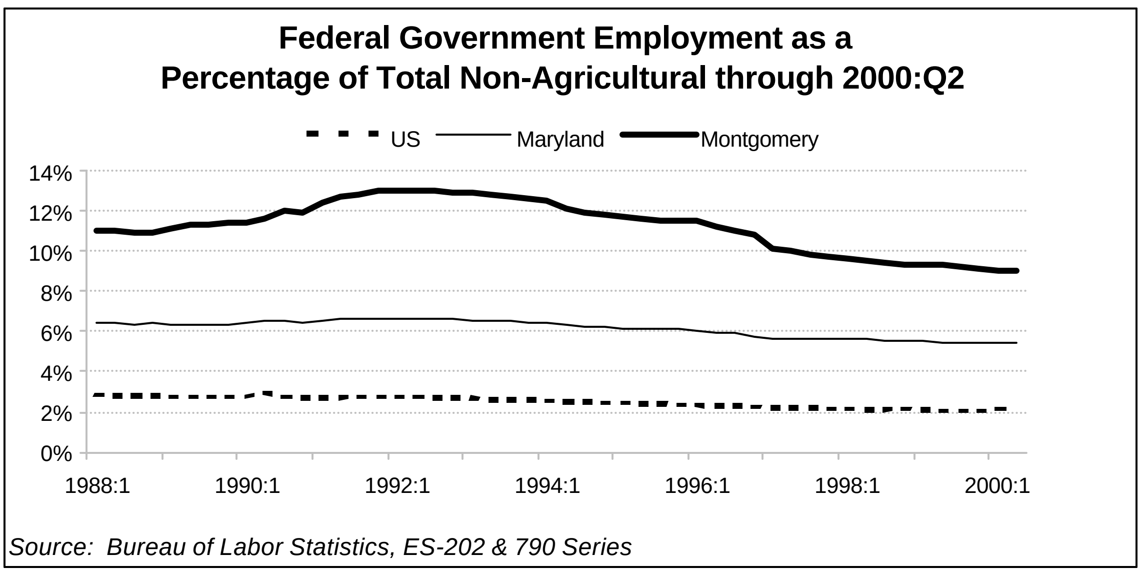
Recent economic fluctuations suggest that the lag between Federal Reserve tightening and loosening of monetary policy and the economy's response ranges between three and four quarters. If history holds true to form, the U.S. economy should begin to improve by approximately the fourth quarter of 2001 since Alan Greenspan began lowering interest rates on January 3rd, 2001.

All told, the first three quarters of 2001 is setting up to be a period of meager growth, perhaps between zero and one and one-half percent. That would represent a harder landing than many economists foresaw, but not a genuine recession. Thereafter, the Federal Reserve's renewed willingness to lower interest rates and provide liquidity to financial markets should begin to manifest itself in an improving investment climate that could set the stage for a decent 2001 Christmas season. RESI views this as the most likely scenario for the year.

B. The Economy of Montgomery County, Maryland – Easily Outperforming Nation

Distinguishing Features – Composition of Economy Favors County's Outlook

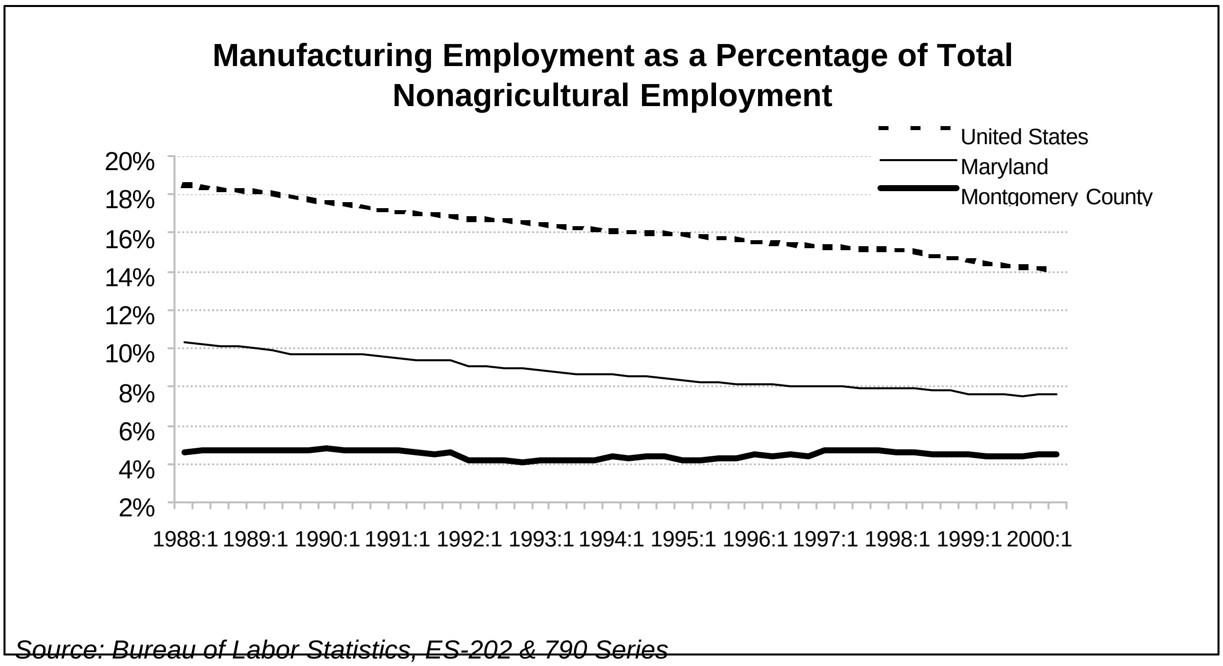
There are at least three features of Montgomery County's economy that serve to distinguish it from the balance of the nation and state. First, the county is enormously wealthy and the accumulation of wealth has been phenomenal in recent years. In terms of both per capita and average household income, Montgomery County ranked 13th among the nation's 3,000+ counties in 2000. Average household income in 2000 was $125,000. Among the 30 percent of Montgomery County families with income exceeding $100,000 in 1998, the median value of stock holdings was $150,000, nearly twice as high as the level of wealth reported among this group just three years prior. Another 40 percent of Montgomery County families reported income between $50,000 and $99,999 in 1998, and among that group, the median value of stock holdings had risen to nearly $36,000 in 1998, more than 50 percent higher than the corresponding figure recorded in 1995.



Montgomery County's employment base is heavily weighted toward employment in federal agencies. As a result, a substantial proportion of the county's economic base is immune to short-term cyclical fluctuations.

Second, the county's employment base is heavily weighted toward employment in federal agencies. Despite several years of recent rapid private sector growth, federal government employment still comprises nearly 10 percent of total employment in Montgomery County compared to less than 6 percent in Maryland and roughly 2 percent nationally. As a result, a substantial proportion of Montgomery County's economic base is immune from short-term cyclical fluctuations. Analysts estimate that federal spending in the Washington area is expanding between 3 and 4 percent per year. Indeed, the Bush administration recently released a budget plan that stands to dramatically improve Montgomery County's short- and long-term economic outlooks. Bush's plan involves spending $2.8 billion more at the National Institutes of Health, a 13.8 percent increase from its $20.3 billion 2001 budget, as he appears poised to follow through on his commitment to double NIH funding from 1998 to 2003. In a speech last September, candidate Bush promised to raise the NIH budget to at least $27.3 billion and maintain that level through 2010.

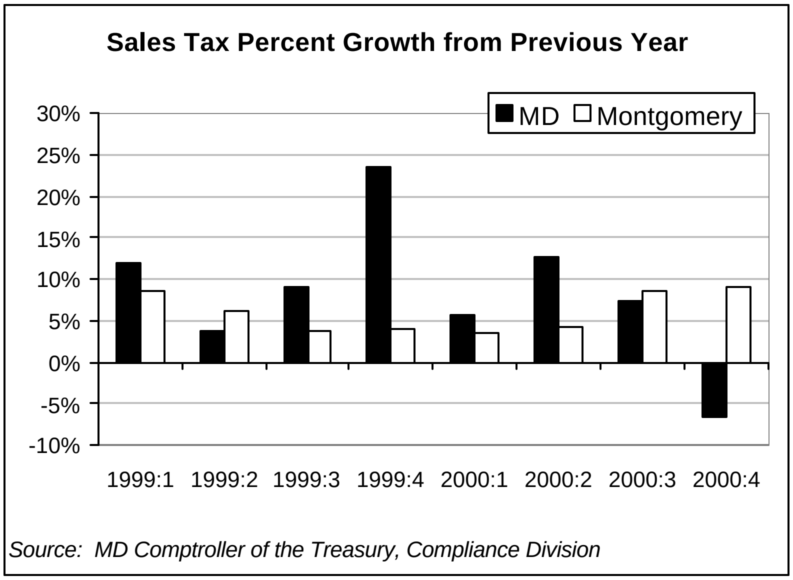
Third, the inventory correction currently underway nationally largely affects manufacturers, particularly those in apparel and auto manufacturing. Neither of these industries plays a substantial role in shaping Montgomery County's economic fortunes, and this is another feature of the county's economic composition that favors the county in the near-term. Manufacturing comprises less than 5 percent of the county's employment base, less than a third the corresponding national proportion.



The inventory correction currently underway nationally largely affects manufacturers, an industry that does not play a substantial role in shaping Montgomery County's economic fortunes.

Recent County Economic Performance – Stronger Than One Would Presume

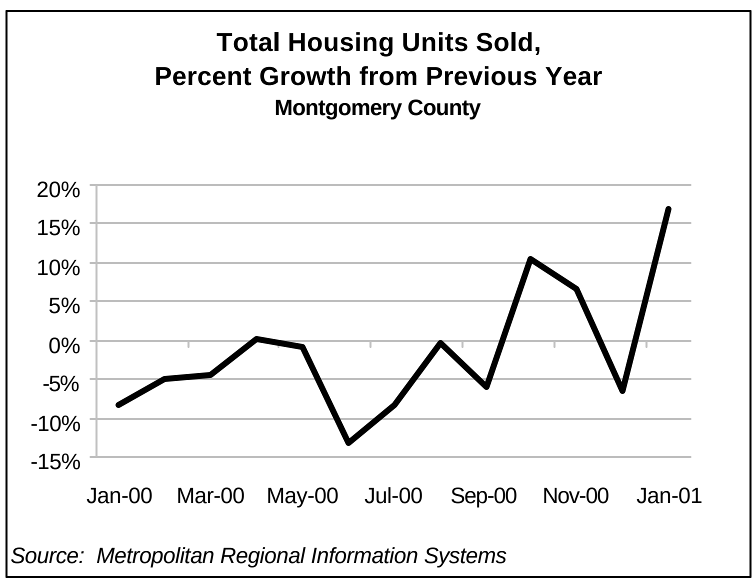
Anyone who considers Montgomery County's economy has presumed a slowdown based on recent developments in financial markets and the national economy. However, a careful analysis of data suggests that until very recently the county's economic slowdown has been extraordinarily mild. Certain data series go so far as to imply that a recovery may have already begun, or alternatively that the slowdown has yet to begin.



Sales tax data imply that a recovery may have already begun, or alternatively that the slowdown has yet to begin. Indeed, from a percentage growth perspective, the retail sales tax data figures are consistent with an improving rather than deteriorating economy.

The sales tax data fall into this category. Percent growth in sales tax collected at Montgomery County enterprises was up nearly 10 percent during the fourth quarter of 2000 from the same quarter the previous year. Indeed, from a percentage growth perspective, the retail sales tax figures are consistent with an improving rather than deteriorating economy. This may appear counterintuitive given the destruction in financial wealth that has occurred over the past twelve months, but the data are consistent with the following hypothesis. During the stock market's banner days in 1997, 1998, 1999 and early 2000, Montgomery County residents rushed to invest their disposable income in mutual funds and other financial instruments, causing a reduction in the amount of retail sales that would otherwise have taken place. With the stock market beginning to collapse in March 2000, residents have been more willing to spend rather than invest, and that may partially explain the counterintuitive sales tax percent growth figures.

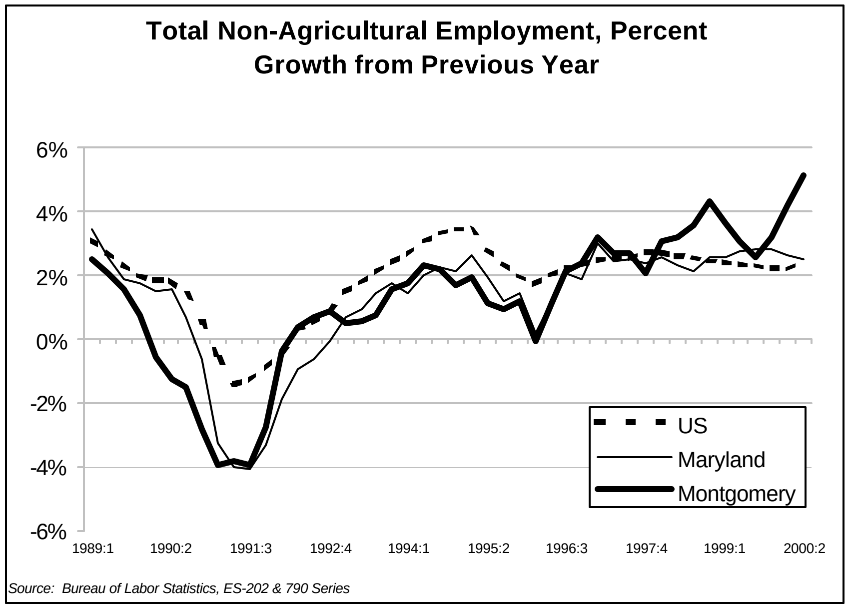
Another possible explanation is embedded in interest rates. For many months last year, long-term interest rates, including mortgage rates, were declining even as the Federal Reserve retained its commitment to high short-term rates. As a result, the housing market began to surge in 2000 even as corporate investment slowed and consumer confidence stumbled. This has been particularly evident in Montgomery County, where homes



Long-term interest rates were declining in 2000 even as the Federal Reserve retained its commitment to high short-term rates. This is evident in Montgomery County, where home sales slumped during the summer months , but have rebounded strongly since.

sales slumped during the summer months of 2000, but have rebounded strongly since. In January 2001, for instance, home sales were more than 15 percent ahead of the same month one year ago. Home sales are a powerful driver of retail activity, especially in the home furnishings and home improvement categories.

A final possible explanation is that analysts have overstated the impact of layoffs in Montgomery County. High profile announcements by Discovery Communications, SpaceWorks and Startec have captured headlines, but have heretofore been unable to upend the overall local economy. Employment data suggest that job growth in Montgomery County was actually accelerating during the second quarter of 2000, and though job growth has unquestionably slowed since then, it is clear from real estate and other data that the extent of the slowdown has not been as substantial as it has been nationally. Recent unemployment data support this view. In Maryland, unemployment actually fell in January 2001 on a seasonally adjusted basis (3.6 percent) from the January 2000 level (3.7 percent). Nationally, unemployment ticked upward to 4.2 percent. In Montgomery County, unemployment stood at a paltry 1.68 percent in December 2000 on a seasonally adjusted basis, actually lower than the figure for October 2000, which stood at 1.72 percent. The point is that unemployment has yet to begin to climb dramatically in Montgomery County, and remains considerably below even 1998 levels when the local economy was thought to be operating on all eight cylinders.



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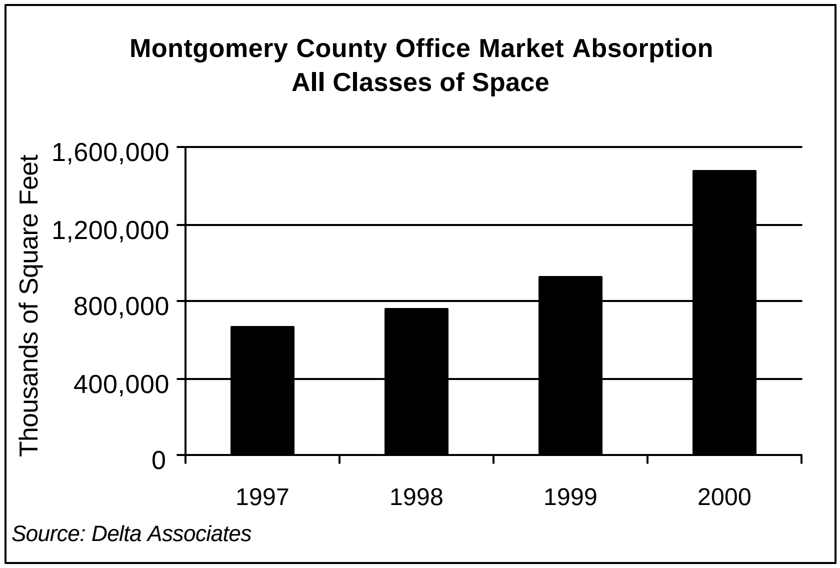
Furthermore, there are companies that continue to expand rapidly in the current environment. Human Genome Sciences inked a deal in March 2001 to purchase three large laboratory and office buildings that will provide the company with room to expand, including the addition of 300 new employees before end-2001. Indeed, the tech labor shortage appears to remain in place in Montgomery County. OTG Software Inc., a Bethesda-based company expanding into new and larger headquarters in Rockville, recently placed ads offering $3,000 for referring software engineers and designers.

One should not interpret these paragraphs as suggesting that RESI believes that Montgomery County's economy is not slowing. The view being put forth here is merely that the slowdown remains extremely mild, especially when juxtaposed against financial market activity, and that to a certain extent the perception of more rapid slowing is the result of attributing national level developments to the local economy on a one-for-one basis. Thus far, the data suggest that Montgomery County's economic slowdown has been exceedingly subtle.

Commercial Real Estate – Holding Up



The office market also appears to be in substantially good shape with absorption remaining strong through 2000.

One segment of the economy that is particularly worth noting because it is disproportionately subject to cyclical fluctuations is real estate, particularly the commercial segment. Here, too, the data suggest that at least through this point, the slowdown has remained mild locally. In the industrial market, the Washington/Baltimore region experienced 9.8 million square feet of net absorption in 2000 compared to 6 million in 1999. This figure equals the highest levels achieved since the mid-1980s, and the region's vacancy rate for industrial space is now 7.3 percent, the lowest level achieved since the early 1980s. Moreover, industrial rents in Suburban Maryland were up 4 percent last year, suggesting that the market has yet to approach the point at which new supply exceeds new demand, though rent growth does appear to be flattening. Though vacancy rates are likely to rise slightly over the near-term, RESI continues to believe that the industrial market will hold up well for the foreseeable future, particularly the market for flex space.

The office market also appears to be in substantially good shape. The Washington metro area office market turned in its best performance ever in 2000 and continues to be one of the top office markets in the nation. Even in the fourth quarter, as the national economy began to soften, extremely strong job growth in the region and continued expansion in high-tech fueled rapid absorption of office space, with rents spiking as a result. The Washington area's stable office market can be attributed to the calming influence of the federal government as a tenant and the less risky tech cluster found in much of the Washington area (e.g., Montgomery County's biotech cluster which has held up well in a market littered with imploded dot-coms).

In Suburban Maryland, there were 3.5 million square feet of office space under construction at the end of 2000 as developers remained optimistic about the region's prospects. Though vacancy rates are likely to rise in 2001, they will not rise to a level that would put in jeopardy the balance of the local economy. The Class A direct vacancy rate (not including sublet space) stood at a favorable 3.1 percent in suburban Maryland at the end of 2000. This suggests that construction activity will continue to be robust going forward, though RESI believes that commercial construction starts will slow in the second and third quarters of 2001 from their current pace, a pace that is already slightly more modest than it was during the third quarter of 2000.

Apartment Market – Rents Continue to Climb

The apartment vacancy rate in Suburban Maryland is now only 0.8 percent. Class A garden rents rose 11.4 percent over the past year, and a substantial number of deliveries were absorbed without the use of concessions. The Rockville submarket led Suburban Maryland in overall performance, managing a 22.1 percent gain in effective rents over the past twelve months. Though vacancies are likely to rise over the next 12-18 months and rent growth will correspondingly flatten, the slowdown in apartment construction is likely to be moderate going forward, and the market will continue to be a vibrant and healthy one even as its pace of expansion slows.

C. Summing Up the Economic Outlook – Dramatic Slowing Will Not Occur

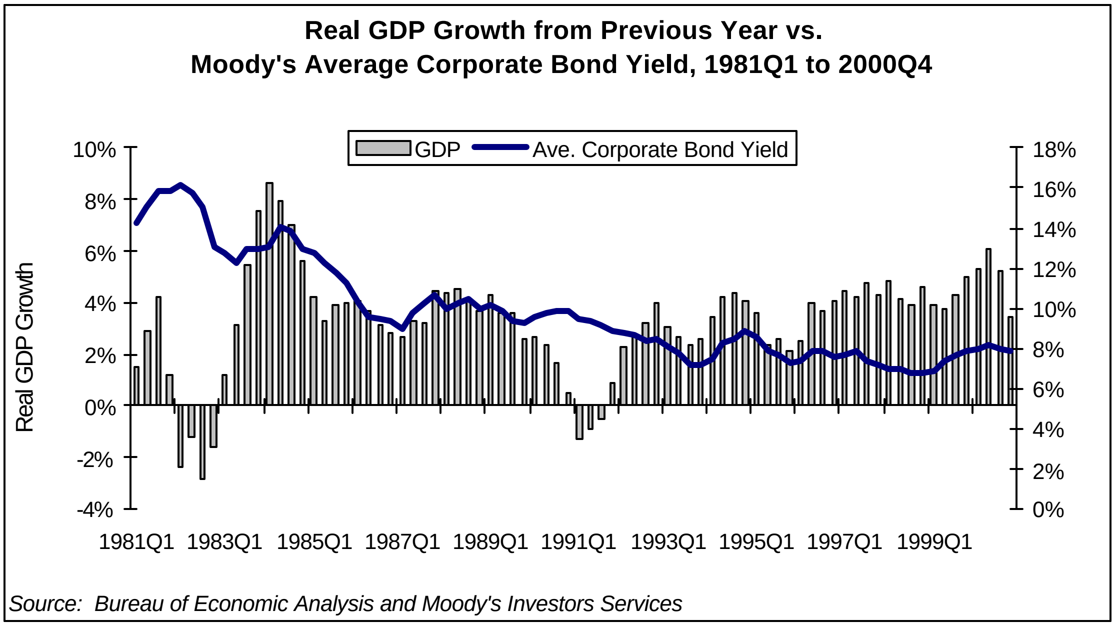
The data strongly suggest that Montgomery County has thus far been able to sustain its robust economy in the face of adverse financial markets and a slowing national economy. With the Federal Reserve now nearly three months into its effort to promote economic growth, Montgomery County's slowdown is likely to be short-lived and relatively subtle, and will span the first three quarters of 2001. Thereafter, economic growth will become more robust for a time until interest rates begin to climb again, and the process will begin anew.

Part II. Reasons to Worry or Celebrate – Alternative Scenarios

A. Alternative Scenario I – Slowdown Avoided

Under this scenario, the wealth effect has little impact on consumption expenditures as consumers recognize that their long-term financial prospects remain bright with the forecast of improving economic and financial market conditions in 2002. George Bush's tax cuts induce Americans to spend, spend, spend, particularly those who most benefit from the tax cut (the wealthy). Lower interest rates further buoy both consumer and company, as economy-wide purchasing and investment rebound, bolstered by idiosyncratic events such as greater federal spending/investment in Montgomery County's technology-related agencies and civilian contractors. Lower rates also usher forth renewed rapid or accelerating expansion among mortgage brokers and other finance industry segments, wholesale trade/distribution and housing construction, which together fuel job growth and additional retail spending.

The region enjoys a surge in productivity as workers displaced from non-viable tech companies find their way into firms with workable corporate strategies previously facing chronic labor shortages, leading to higher incomes in the region even in the face of



Lower interest rates buoy both consumer and company, as economy-wide purchasing and investment rebound, bolstered by idiosyncratic events such as greater federal spending/investment in Montgomery County's technology-related agencies and civilian contractors. Lower rates also usher forth renewed rapid or accelerating expansion among mortgage brokers and other finance industry segments, wholesale trade/distribution and housing construction, which together fuel job growth and additional retail spending.

substantial corporate bankruptcy. The result is a more efficient technology sector both in Montgomery County and nationally, propelling the NASDAQ ever higher during summer 2001, helping to replenish consumer and investor confidence and allowing seed and venture capitalists to rediscover their zest for life.

Fiscal vitality is quickly restored as the cycle of bonuses and stock options resume, and as the race to attract the best and the brightest resumes. In order to house their new workers, commercial construction quickly revs up to meet projected demand, and the cycle returns back to where it was in 1997 when the boom of the late 1990s really began to take off. Labor shortages regain their position as number one business complaint, leading to ballooning wages and tax receipts, allowing Montgomery County to continue to investment in infrastructure and quality of life, leading to substantial numbers of relocations and expansions in the county.

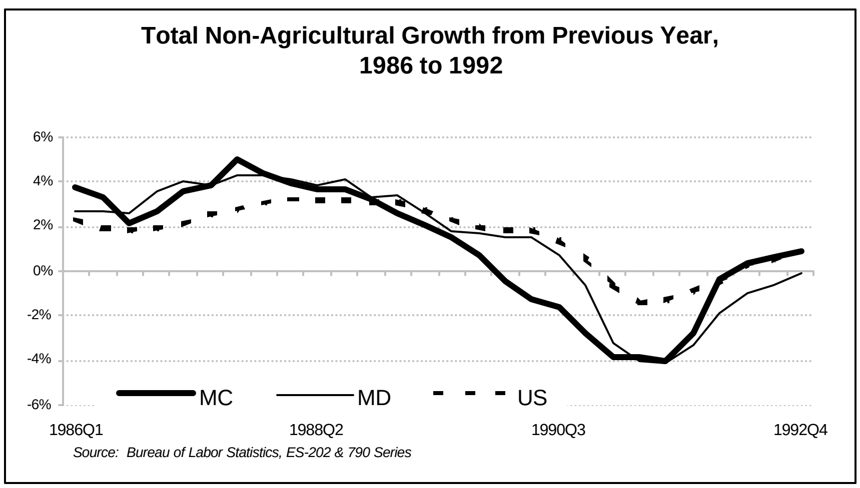
RESI views this scenario viewed in its totality as unlikely for the following reasons. The tech wreck is unlikely to recover instantaneously, and venture capitalists and other financiers are probably less willing to fund new ventures than they were two years ago. RESI expects that it will be many years until the level of financial liquidity offered to tech companies in 1998 and 1999 returns, and that's good from the perspective of economic stability.

Moreover, RESI clearly sees signs of subtle slowing in various real estate markets. Supply has now caught up with demand and is now beginning to exceed it in several market niches, with the result being prospective increases in vacancy rates and diminished commercial construction activity.

Finally, consumers have told economists that their near-term outlook is in fact not particularly good. As a result, the pace of spending will decrease over the next several months, and the economy has yet to feel the impact of the wealth effect related to the precipitous decline in financial markets that has occurred since February 2001. The summer months are unlikely to be ones in which consumers remain as active as they have been (on a seasonally-adjusted basis, of course) simply because they are in fact less wealthy and less assured. On top of this, should financial markets begin to rebound in summer 2001, consumers are likely to curtail spending in order to jump back into the market, a factor that has served to diminish spending in recent years prior to 2000.

B. Alternative Scenario II – Early 1990s Revisited

Under this scenario, the U.S. economy is dragged headlong into recession by the continued deterioration of financial markets. Investment slows to a crawl as companies find it impossible to raise capital from equity markets, and banks remain unwilling to lend in an increasingly uncertain environment. Lower investment leads to lower economic growth overall, propelling the nation's unemployment rate from its current 4.2 percent level to a level approaching 5 percent. Consumer confidence plummets to recessionary lows as bankruptcies surge, leading to financial market upheaval similar to that of the late 1980s. Though no full-fledged S&L crisis emerges, borrowers find it difficult to finance homes and cars, further limiting spending and bringing the U.S economy to a halt.



Investment slows to a crawl as companies find it impossible to raise capital from equity markets, and banks remain unwilling to lend in an increasingly uncertain environment. Lower investment leads to lower economic growth overall, propelling the nation's unemployment rate from its current 4.2 percent level to a level approaching 5 percent. Consumer confidence plummets to recessionary lows as bankruptcies surge, leading to financial market upheaval similar to that of the late 1980s.

Precisely at this moment, federal revenues come in far less than expected, and the recently passed tax cut proves unaffordable. Federal downsizing resumes, stinging Montgomery County's employment base, causing deep pain among local retailers, construction contractors, and service providers, each of which begin laying off staff. The result is an economy in free-fall that is unable to respond to low interest rates. The federal government would like to provide fiscal stimulus, but finds that it has already done that to no avail.

In such an environment, biotechnology and information technology firms find that their sources of financing have completely dried up, and high-wage job creation diminishes yet further. The federal government also cuts back its procurement, and decides that increased NIH funding will have to wait. The result is a Montgomery County economy that looks much like that of the early 1990s when one sector's adversity quickly translated in another's.

Thankfully, RESI also believes this scenario to be unlikely. The excesses built up during the 1990s are qualitatively different from those originating during the late 1980s, and much of the excess has already been eliminated (i.e., NASDAQ stock valuations). Developers appear keenly aware of the prospects for higher vacancy rates resulting from slower job growth, and have already begun to pull back even though demand hardly budged through the end of 2000. The Federal Reserve initiated cuts in interest rates in January, and history suggests strongly that these cuts will begin to make their impact felt by the latter half of 2001.

Further, during the early 1990s, Montgomery County's intimate relationship with the federal government served to deepen the recession as federal cutbacks in jobs and procurement merely exacerbated the poor outcomes associated with an already slowing economy. This time, the federal government appears to be working as a buffer against economic cycling, and though no Maryland economist will ever again make the mistake of pronouncing the state or one of its jurisdictions recession proof, it does appear that Montgomery County is especially well-positioned to weather the storm.

Part III: Review of Economic Indicators

Although each annual update of *Economic Forces That Shape Montgomery County* has one or more special features[1], there are four core areas that updated each year:

- **Job Growth:** This section consists of a review of the most recent statistics on jobs created or lost by each industry in Montgomery County, compared to the state and the nation, with special emphasis on the County's technology sectors. This section relies on ES-202 data compiled by each state and reported to the U.S. Bureau of Labor Statistics. These data are tabulated by RESI at Towson University for the Research & Technology Center staff in a format that RESI originally developed to for their own analyses of state and regional economies.

- **Federal Impact:** By far the largest single influence on Montgomery County's economy is the Federal government: as an employer, as a landowner, as a tenant, and as a purchaser of goods and services. Each year, Research & Technology Center staff survey each Federal installation in the County about current and expected employment changes, construction plans, and space leasing activities. Research staff also analyze federal purchasing and contracting activity using data supplied by the Federal Procurement Data Center.

- **Commercial Space Activity:** The relationship of economic trends to the pace and character of development is of particular interest to officials and staff making land use decisions. One of the major questions addressed by the first *Economic Forces That Shape Montgomery County* report focused on understanding the collapse of the commercial space market that occurred during the 1990-91 recession. Subsequent reports have focused on tracking and understanding the market's recovery as well as looking for signs of pending weakness.

- **Well-Being:** These data elements attempt to measure how economic trends are affecting the well-being of County residents. Many of the data that best describe well-being are not easily obtainable or are not reported annually. This report updates all of the measures of economic well-being from the 2000 report for which new data are available. The Research & Technology Center intends to continue to explore this issue in depth as more data from the 2000 Census are released.

[1] Special features in the 2000 Update included a profile of the labor force and a review of measures of well-being (completed in conjunction with a study of the use of "quality of life" indicators). The next opportunity for a review of labor force demographics will be upon release of more detailed 2000 Census data.

Job Growth

Montgomery County added 20,464 jobs between the second quarter of 1999 and the second quarter of 2000 for a growth rate of 4.8 percent. That represents an acceleration over the 4.0% growth rate (16,938 jobs) recorded between the *first* quarters of 1999 and 2000.

The March 2000 edition of *Economic Forces That Shape Montgomery County* reported annual job growth of 14,923 jobs, for a growth rate of 3.7 percent. That, in turn, was an increase over the 13,000 jobs (3.1 percent growth) added in the previous year.

The 20,464-job increase is larger than any annual increase in the 1990s and the fourth straight year of healthy job growth.

Private sector jobs grew by 19,203, or 5.6 percent. The services sector accounted for 55 percent of private sector job growth: 10,500 new jobs – a growth rate of 5.6 percent. Last year, growth in services accounted for 70 percent of private sector job growth, indicating that job growth was more broad-based in 2000. The construction sector had the fastest job growth rate of any major sector: 11.9 percent, which translates into 2,800 new jobs. Two smaller sectors showing large growth rates were durable goods manufacturing (up 9.6 percent to 11,100 jobs) and agriculture (up 9.5 percent to 4,500 jobs). In addition to the services and construction, the retail sector also showed large absolute gains: 2,600 new jobs for a growth rate of 3.7 percent. None of the County's major sectors had job losses.

Public sector job growth was comparatively slow: 1.7 percent for a total of 1,261 new public sector jobs. This is slower than the 2.5 percent recorded in last year's report -- entirely caused by a slowdown in local government job growth, since federal job growth accelerated (from 275 new jobs between 1998 and 1999 to 623 new jobs between 1999 and 2000) and the state reversed a trend of job losses and added 26 jobs between 1999 and 2000.

The High Tech Sectors

Montgomery County's high technology sectors aerospace, biotechnology, information technology, telecommunications, and high-tech manufacturing – are growing more than twice as fast as the economy as a whole. High jobs grew by 11.9 percent between the second quarters of 1999 and 2000, while the growth rate for all sectors was 4.8 percent. There are now 78,000 private sector high technology jobs in Montgomery County, which is 17.6 percent of all County jobs.

The 78,000 figure does not include the many public sector high tech jobs in Montgomery County, including those at federal installations such as the National

Institutes of Health, the National Institute for Standards and Technology, and the Department of Energy.

Montgomery County's 11.9 percent growth rate for high tech jobs outpaces the 8.3 percent growth rate for the state of Maryland and the 3.3 percent growth rate for the nation.

For the first half of the 1990s, Montgomery County's information technology sector underperformed the region, state, and nation. Beginning in the final months of 1996, the reverse has been true. In 1998, the information technology sector grew by 10 percent; in 1999, by 14.4 percent. The latest data now put the sector growth pace at 10.5 percent, about the same as the rest of the state and about double the pace of the nation as a whole. At the second quarter of 2000, there were about 26,700 information technology jobs in Montgomery County.

A signature industry for Montgomery County is biotechnology. For much of 1998 and 1999, the number of jobs in this sector hovered between 10,000 and 11,000. Between 1999 and 2000, however, the number of jobs jumped 14.2 percent to 12,166. This easily outpaces the performance of the state (7 percent) or the nation (2 percent).

In 2000, Montgomery County regained all of the aerospace industry jobs it had lost since its peak of 17,800 in 1989. Montgomery County's aerospace industry how has 18,100 jobs and grew 15 percent between 1999 and 2000. This is substantially faster than the 4.2 percent rate recorded last year and well ahead of the state and nation.

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 added few jobs until the 1998-1999 period, when job growth rose to 3.5 percent. For 1999-2000, telecommunications job growth surged to 12 percent to 12,900 jobs. This is more than double the state rate of 5.6 percent and three times the growth rate for the nation (4.0 percent).

High tech manufacturing in Montgomery County consists of companies manufacturing industrial machinery, electronic equipment, transportation equipment, and instruments and measuring devices. At 8,100 jobs, the sector is relatively small. Between 1988 and 1992, the sector lost 20 percent of its jobs, but has been growing steadily ever since. As of the second quarter of 2000, jobs in the sector were growing at a 14.6 percent rate.

Other Top Performing Sectors

"Business services" is a major component of the County's large services sector. Business services encompasses computer and data processing, advertising, personnel, mail and reproduction, and services to buildings. Because it includes firms that literally "serve businesses," growth in this sector is a good indicator of economic strength.

Montgomery County's business services sector grew by 6,500 jobs, or 12.2 percent, between the second quarter of 1999 and 2000. There are now 60,000 business services jobs in Montgomery County. This compares favorably to the 5.6 percent growth rate for the state and the 6.0 percent growth rate for the nation. Montgomery County has 28 percent of all the business services jobs in the state (compared to 18.5 percent of the state's jobs of all kinds).

Engineering and management services is a sector that includes engineers, architects, accountants and management consultants and is Montgomery County's second largest sector, having just surpassed health services in 2000. It also the sector adding the second largest number of new jobs after business services. Engineering and management services added 2,200 new jobs between 1999 and 2000, a growth rate of 6.8 percent. There are now almost 34,000 engineering and management services jobs in Montgomery County.

Another Montgomery County "signature" industry is the hotel and lodging sector because we are home to the headquarters of two of the nation's leading hotel corporations, Marriott and Choice. In recent years, job growth in this sector has been very rapid, average 15 percent per year between 1997 and 1999. In 1999, however, job growth reached a plateau of about 8,400 jobs where it remained through the second quarter of 2000. Presumably because of the headquarters jobs located in the County, the lodging industry typically paid higher-than-average wages in Montgomery County. Over the past year, average wages have declined to about the same as the County as a whole – about $43,000 per year.

The highest-paying sectors in Montgomery County are: chemicals (1,081 jobs; average wage: $191,000), transportation equipment (678 jobs; average wage: $123,000), holding and investment offices (427 jobs; average wage: $92,000), and security and commodity brokers (2,280 jobs; average wage: $88,000). Among sectors with more than 5,000 jobs, the top wage-payers are electronic equipment (6,060 jobs; average wage $74,000), communications (7,605 jobs; average wage $67,000), wholesale trade in durable goods (10,123 jobs; average wage $65,000), and engineering and management services (34,000 jobs; average wage $57,000).

As noted above, the average salary paid by a Montgomery County job is $43,000 per year. The average private sector job pays about $41,000 while the average public sector job pays $50,000. The comparatively higher salaries paid by the public sector are due to the federal government salaries, which average $61,000. Local government jobs pay an average of $38,500 while state government jobs pay an average of $28,000. Of the major private sectors, retail trade jobs pay the lowest average wages, about $21,500 per year.

Job Growth Statistics in Perspective

The most recent job growth statistics – for the second quarter of 2000 – are among the healthiest recorded by the County. The total of new jobs – 20,464 – is quite large compared to the rest of the 1990s (which averaged 6,900 jobs per year) although it doesn't match the County's 1985 peak of 28,000 jobs in one year.

A major question is whether these second quarter job growth statistics are indicative of the current state of Montgomery County's economy or represent a peak from which the County's pace of growth has retreated. Nationally the second half of 2000 showed increasing evidence of an economic downtown and it is reasonable to assume that job creation in Montgomery County slowed in the second half as well.

Part II of this report is an analysis by RESI at Towson University which examines indicators of the current and near future health of the County economy.

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 1999, the federal government paid workers in the County $2.7 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 rising. According to a survey of 12 federal agencies, jobs in federally-owned and leased space increased by 4,200 from February 2000 (54,800 jobs) to February 2001 (59,000 jobs), an increase of 7.7 percent. Most of the increase came in the Department of Health and Human Services (H&HS). The National Institute of Health (NIH) reports 2,300 more workers than a year ago, reporting increases on their campus and in leased space. H&HS, other than NIH and the Food and Drug Administration (FDA) reports 2,000 more workers than a year ago all in leased space. Collectively, the agencies surveyed anticipate job levels increasing by another 7 percent (4,000 jobs) through 2005 and then anticipate job increases of 3 percent between 2005 and 2015 when workers at these agencies will number about 64,700.

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 2001 and 2015, and workers in federally leased space are expected to decline by 6,400. The main shift from leased to owned space will be the FDA's consolidation at their facility in White Oak.

Federally Leased Space

Federally leased space has remained relatively unchanged since December 1999. The General Services Administration (GSA) leases 6.5 million square feet of space in Montgomery County, about 12 percent of the County's existing rentable office space.

Over half of this space, 65 percent or 4.2 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 1.1 million square feet of leased space is 17 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 3.5 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 1.3 million square feet (20 percent) and Bethesda has 1 million square feet (16 percent).

Federal Procurement

Fiscal Year 2000's $3.8 billion procurement spending in the County is the County's all time high, an increase of 10 percent over FY1999. During the same period, federal procurement rose by 11.7 percent in the Washington Area and by 11.2 percent nationally. Over the past ten years, the County's federal procurement increased at a respectable annual compound growth rate of 7.2 percent, though lower than the Washington Area's annual compound growth rate of 8.6 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 Health and Human Services and Defense are the source of over half the procurement dollars spent in the County. H&HS spent $1.25 billion, 33 percent of total procurement, and Defense spent $1.16 billion, 31 percent. H&HS had the biggest gain in procurement spending surpassing last year's total by $351 million, a 39 percent increase. Procurement spending by the Department of Commerce more than doubled over the past year, increasing by $217 million, up 152 percent. The biggest drop in procurement spending was by the Department of Transportation who spent $247 million less than last year, a drop of 88 percent.

More than half the federal procurement spent in the County in FY2000 was spent on Business Services, 31 percent or $1.2 billion, and Engineering and Management Services, 23 percent or $856 million. Almost 90 percent of the Business Service procurement was spent on computer related services, such as systems design, computer maintenance and repair, facilities management, data processing, and programming services. Almost 80 percent of the Engineering and Management Services procurement was spent on management services, engineering services, management consulting services, and commercial physical research.

Commercial Real Estate - Where is the Real Estate Economy Headed?

The Washington regional and Montgomery County commercial real estate economies have been in the expansion phase of the real estate cycle for the past five years. During this time a large number of buildings, particularly class A office buildings, have been built, millions of square feet have been absorbed, vacancy rates have declined and rents have increased. All of these indicators show that we are in the expansion phase and they have continued to improve into the first quarter of 2001. This expansion has reached into all parts of the market both geographically and across building types. The renaissance of Silver Spring's town center has resulted in a much stronger office market too. Class B and C office buildings have lower vacancies and higher rents. The flex space and industrial/warehouse markets are also stronger.

The availability of space has been so tight that finding space to expand has been a major problem for many growing companies. A five percent vacancy rate is considered healthy, giving a good return to building owners while allowing flexibility for firms on the move. The Class A office vacancy rate is 3.43% for the region and 2.61% in Montgomery County. A little loosening of this situation would be beneficial.

While this expansion has been strong, it does not seem to have resulted in the excessive overbuilding of the late 1980s that led to the very painful real estate market collapse of the early 1990s and the Resolution Trust Corporation's sale of many bankrupt properties at very depressed prices. Half of the office space under construction both here and in Fairfax is already under lease.

The only negative sign on the horizon is an increase in sublet office vacancies. Sublet vacancies can change more rapidly than other indicators as firms find they don't need all the space they have leased and put it back on the market. Most of this rise has occurred in Fairfax where the sublet vacancy rate in Class A office has shot up from 1.20 percent on January 1st to 3.23 percent in late March 2001. This jump is probably a result of the layoffs in the dot.com sector that is particularly concentrated in Fairfax. Montgomery's rate increased from 0.67 percent to 1.74 percent by mid-March but has since moderated to 1.50 percent. In Fairfax, the total Class A vacancy rate, including sublet space, stands at 6.7 percent compared to 4.1 percent in Montgomery County.

If the region were to fall into a true economic recession, the vacancy problem would spread, absorption could turn negative and the commercial real estate economy would slip into the oversupply phase of the cycle. At this time it is too early to say if this will happen. Staff believes that the greatest likelihood is that the pause we are seeing now will be temporary based on the extensive strengths of the region's and the County's economies and that available space will soon be taken by our many strong growing companies. A good recent example of this is the way Human Genome Sciences seized the opportunity to take over Life Technology's building at Shady Grove.

Measures of Well-Being

Most of the measures of well-being tracked by the Research & Technology Center for *Economic Forces That Shape Montgomery County* have improved, with two exceptions. The major exception is housing affordability, which is showing the effects of strong demand induced by rapid job growth. A second source of concern is the continuing increase in auto travel, which suggests a worsening of congestion on some roadways. On the plus side however, are very good – which is to say, *low* -- numbers for unemployment, temporary cash assistance cases, and the crime rate. Real income growth is modest at just 0.4 percent.

Montgomery County's unemployment rate was 1.7 percent in January 2001, near it's record low of 1.4 percent, according to the Maryland Department of Labor, Licensing and Regulation. The unemployment rate is one of the few current indicators of local economic conditions, and the very low rate suggests that Montgomery County job base is still experiencing net increases. However, it should be noted that even during economic downturns, Montgomery County's unemployment rate varies by just a few percentage points. During the past recession (1990-1992), the unemployment rate peaked in 1992 at 3.9 percent and was only above 3.5 percent for three months.

Temporary cash assistance (TCA) cases (formerly known as Aid to Families with Dependent Children or AFDC) are another good signal of current economic conditions. In addition, according to research by RESI Research & Consulting at Towson University, caseload increases are among the best predictor of recessions and recoveries. Montgomery County's TCA caseloads peaked in 1995, prefiguring the job growth rebounds in 1996 and beyond.

The number of temporary cash assistance cases in Montgomery County in February was 2,339. This is slightly above the November 2000 figure of 2,026, which was a two-decade low. The current TCA caseload is well below the 8,000 level recorded during the mid to late 1980s.

The median household income grew by 0.4 percent between 1999 and 2000, compared to a 0.5 percent growth rate in 1998-99. These are "real" growth rates, meaning that they have been adjusted for inflation. The median household income in Montgomery County is now $73,980.

Montgomery County's Housing Affordability Index declined 7.4 percent between 1999 and 2000 to 1.02. This index measures the ability of a household earning the median income to purchase the median-priced single-family home. A score greater than 1.0 means that a household earning the median income is spending *less* than 30 percent of its gross income to afford the median-priced home; a score of less than 1.0 means that a household earning the median income is spending *more* than 30 percent of its gross income to afford the median-priced home. The 1.02 figure is for all single-family homes, new and existing, detached and townhouse.

The Research & Technology Center also prepares a Housing Affordability Index for each type of housing. The scores for 1999 and 2000 are as follows:

	1999	**2000**
New Single-Family Detached	0.64	0.56
Existing Single-Family Detached	0.93	0.83
New Townhouses	1.06	0.87
Existing Townhouses	1.62	1.53

Note that existing detached homes and new townhouses were very close to a score of 1.0 in 1999 but are now well below. Only existing townhouses remain affordable to the typical middle-income household.

The decline in affordability is due to two increases: home prices and mortgage rates. In the case of new homes, a portion of the increase in median price is due to a greater proportion of upscale townhouses being built in areas such as Bethesda and Potomac. Mortgage rates have declined in 2001. However, most of the change is due to strong market demand for housing in the County, and while the acceleration of that demand will slow in 2001, the Research & Technology Center expects continued upward pressure on home prices through the balance of the year.

Rental housing is also less affordable in 2000. According to the Office of Landlord-Tenant Affairs annual survey, Montgomery County's already-tight apartment market tightened further. Apartment vacancy rates declined to 2.5 percent from 3.0 percent in 1999. The development community generally considers a vacancy rate of 5.0 percent to be a strong signal that the market can support new development. Apartment rents are also increasing. The average rent increased by almost 8 percent between 1999 and 2000, from $861 to $928.

Although the Research & Technology Center does not prepare a Rental Housing Affordability Index, the two trends of low vacancy rates and high rents mean that renting households earning much below the median income are having difficulty finding apartments they can afford in the County.

Continuing a trend reported last year, Montgomery County's crime rate fell 15 percent in 2000. The violent crime rate fell 17 percent while the property crime rate fell 15 percent, according to Maryland State Police Uniform Crime Reports. Although there are numerous factors affecting crime rates, there is a documented association of crime rate with economic health. In Montgomery County, for example, both the unemployment rate and the crime rate peaked in 1992.

Also reflecting a healthy economy, vehicle miles of travel (VMT) increased in 2000, up 0.2 percent over 1999. The State Highway Administration reports that Montgomery County's VMT was 6.8 billion in 2000. This is a much slower rate of growth than the average of 3 percent in the 1990s.

(This section of the report includes slides from the *Economic Forces That Shape Montgomery County 2001* slide presentation which is available at www.mc-mncppc.org).

Acknowledgments

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