D.C. POLICY CENTER

OVERSIGHT HEARING ON

The Future of the Capital One Arena

Before the Committee on Business and Economic Development

Chairman Kenyan McDuffie

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Hearing in Room 412

Testimony of Dr. Yesim Sayin

Executive Director

D.C. Policy Center

Good afternoon, Chairman McDuffie, and members of the Committee on Business and Economic Development. My name is Yesim Sayin, and I am the Executive Director of the D.C. Policy Center—an independent non-partisan think tank advancing policies for a strong, competitive, and vibrant economy in the District of Columbia. I am grateful for the opportunity to testify.

The District is now operating under a new normal. Because of remote work, people in the region are commuting less, economic activity is more localized, and competition from remote, lower cost locations—be it exurbia, or a sunbelt state—is much stiffer.

Revitalizing Downtown and charting a strong course for development in the vicinity of the Capital One Arena should be the city's priority. Importantly, Downtown D.C. is not isolated from the rest of the city. Policies that promote a healthy business environment across the city and make D.C. an attractive place to live and work will also increase the returns on any investment the city makes in Downtown recovery. The most important thing the city can do now to chart a stronger fiscal future for the Downtown is to become more competitive, more attractive to residents, workers, and businesses, and more appealing to capital investment. This requires refocusing the policy discourse in the District of Columbia on the fundamentals of success: economic growth, competitiveness, and opportunity.

Demand for D.C. is weakening.

The swift and persistent shift to remote work has broken the relationship between where we work and where we live.[1] This has been a fundamental change for the District's economy as it influenced migration, commute patterns, and business relocation decisions, significantly reducing "demand for D.C."

Weakening interest in the city is evident in employment numbers. The most recent Bureau of Labor Statistics report on employment shows, in the past year, employment in

[1] Bailey McConnell and Yesim Sayin (2022). "Remote work and future of D.C, Parts 1 and 2." Available at https://www.dcpolicycenter.org/publications/remote-work-future-dc-part1/ and https://www.dcpolicycenter.org/publications/remote-work-dc-2/

the District grew by only 1 percent.[2] However, this growth is not "statistically significant." It may simply be noise in the BLS's employer survey.[3] That means we can't reliably say that the city is experiencing employment growth.[4]

In the era of remote work, a more apt metric of employment is "job activity," which adjusts employment figures to account for where the work takes place.[5] Measured this way, employment in the region has become increasingly sprawled, with an emptying core (the District) and swelling donut (suburbia and exurbia). For example, the District's share of workers in business and financial occupations in the metro region declined from 30 percent in 2019 to 21 percent post-pandemic. Prior to the pandemic, 54 percent of the region's lawyers worked in D.C. Post pandemic, that share is 37 percent. Importantly, service sector jobs have followed remote workers, reducing the District's share in employment in arts, entertainment, media, food prep and service, and personal care and service occupations.

The weaker demand for D.C. is also evident in shifts in demographic trends. Between 2010 and 2018, the District experienced strong domestic in-migration, which brought nearly 30,000 residents to the city[6]—mostly millennials—who then chose to stay in the city at historically high rates after they formed families and their children began to attend D.C.'s public schools.[7] This influx of new residents contributed to growing resident

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[2] And it still remains nearly 26,000 below pre-pandemic levels (BLS reports total employment in D.C. at 778,800 for November, and 544,400 for private sector employment). Daniel Burge (2023). "Employment growth in traditionally important D.C. sectors has been weak." Available at https://www.dcpolicycenter.org/publications/week-growth-in-important-sectors/ Yesim Sayin (2023). "Is there any job growth in D.C.?" Available at https://www.dcpolicycenter.org/publications/is-there-any-job-growth/

[3] Administrative data, which runs about a quarter behind do show zero growth. Yesim Sayin (2023). "Is there any job growth in D.C.?" Available at https://www.dcpolicycenter.org/publications/is-there-any-job-growth/

[4] Washington Metropolitan Area employment growth has outperformed D.C. In November 2023, metro area employment, at 3,383,000 was 1.6 percent over November 2022 levels, and 1.4 percent above the pre-pandemic peak.

[5] Bailey McConnell and Yesim Sayin (2023)." Worker sprawl in the Washington metropolitan area: Is D.C. still the region's job hub?" Available at https://www.dcpolicycenter.org/publications/worker-sprawl/

[6] Data compiled from the U.S. Census for various years using Components of Population Change.

[7] Ginger Moored and Lori Metcalf (2014), "D.C. Parenthood: Who Stays and Who Leaves?" Available at https://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/DC%20Parenthood%20--%20Who%20Stays%20and%20Who%20Leaves.pdf.

employment, higher resident incomes, and higher income tax revenues for years to come.[8] Between 2015 and 2021, the District's individual income tax revenue, adjusted for inflation, grew by 20 percent,[9] nearly twice the pace of growth in real GDP across the Washington metropolitan area.

In contrast, between 2020 and 2023, the city has lost 26,210 residents to net domestic outmigration. This has meant fewer families,[10] fewer babies,[11] and a lower demand for D.C.'s public schools.[12] Many of those who left are higher income residents[13] or residents with high income potential.[14] High housing and childcare costs have always been factors driving families out of the city. Nonetheless, the declining importance of commute times post-pandemic made such a move easier and shifted demand for housing from the District to the outer suburbs of the Washington metropolitan area, which offer lower costs of living and different amenities valued by families.[15]

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[8] Their impact is most obvious in the quick recovery the District experienced from the Great. When the rest of the country was experiencing high levels of unemployment, the District added 8,200 jobs, and 25,000 new residents including 16,000 working adults. As a result, personal incomes (adjusted for inflation) grew by an annualized 2.1 percent even through the recessionary years (2007 to 2010). For further information see Yesim Sayin (2020), "Tax policy under the District's new "fiscal normal." Available at https://www.dcpolicycenter.org/publications/tax-policy-under-new-fiscal-normal/

[9] This is calculated by comparing the actual personal income tax revenue collected in 2021 and 2015 reported by the Office of the Chief Financial Officer, after adjusting for inflation.

[10] Bailey McConnell and Yesim Sayin (2023). "D.C.'s household growth is predominantly driven by singles aged 25 to 34." Available at https://www.dcpolicycenter.org/publications/household-growth-singles/.

[11] In 2022, there were 8,075 births in D.C., a low figure not seen since 2005. Yesim Sayin and Chelsea Coffin (2024), "The fiscal future of public education in the District of Columbia." expected publication date: February 13, 2024.

[12] Measured by the cohort retention rate: For example, in kindergarten—the first mandatory school grade—enrollment is 76 percent of those born in D.C. five years earlier, down from 79 percent before the pandemic.

[13] Daniel Burge and Nick Dodds (2023). "Higher income households move to D.C. often and move out of D.C. even more often." Available at https://www.dcpolicycenter.org/publications/household-migration-income/

[14] Yesim Sayin (2023). "What does the IRS migration data tell us about outmigration from D.C.?" Available at https://www.dcpolicycenter.org/publications/irs-migration-flows/

[15] Zillow data shows that prior to the pandemic, housing values in DC were growing at rates comparable to the rest of the region. In the aftermath of the pandemic, housing values in outer suburbs began to increase at an annualized rate of 20 or more percent, or up to three times the appreciation rates in D.C. For details, see Yesim Sayin (2021). The declining importance of commute times. Available at https://www.dcpolicycenter.org/publications/the-declining-importance-of-commute/

Businesses are also leaving or reducing their presence in the District. We need look no further than commercial office buildings to observe the weakening demand and its devastating impacts on the city's revenues. CoStar data show in the last 12 months, the net *negative* absorption in the District's office market was over 2 million square feet.[16] The East End and the Central Business District markets collectively hold 61 percent of the District's office inventory and 64 percent of the asset values, but they account for 88 percent of the loss in absorption. The vacancy rates in these two areas are projected to increase to 27 percent by 2027, resulting in an asset value loss of 35 percent, according to CoStar. If these projections are correct, they would translate into a tax revenue loss of nearly $400 million each year by 2027, from the peak in 2021.[17] If this happens, everyone stands to lose, including District residents who need supports and residents who benefit from services provided by the government and funded by tax dollars.

These all translate to significantly impaired demand from capital markets as investors are increasingly sending their capital elsewhere. Prior to the pandemic, the District was seen as a safe haven for investors given its ability to weather recessions with relative ease, because of the federal government's presence and strong population growth. An international investors survey from 2022 showed 81 percent of investors believed the pandemic permanently altered culture and live-work preferences, 71 percent indicated they plan to invest in secondary US cities like Atlanta, Austin, Boston, and Dallas.[18] Further, they plan to shift their investments to multifamily housing, industrial uses, life sciences, and storage—all areas where the District faces significant challenges. International investors are still planning to invest more than half of their capital in the U.S.,

[16] For context, the total office inventory in the city is approximately 169 million square feet.
[17] Costar estimates show an asset devaluation by over $21 billion from the highest recorded value of $61 billion in early 2021. Also see Nick Dodds (2023), "The pandemic's shadow still looms over D.C.'s commercial real estate market." Available at https://www.dcpolicycenter.org/publications/commercial-real-estate-submarkets/, and Yesim Sayin (2023), "How much is commercial office property worth in D.C.?" Available at https://www.dcpolicycenter.org/publications/commercial-office-property-values/.
[18] See also Bailey McConnell (2022) "What do migration and labor force trends tell us about D.C. and other large, high-cost metro areas?" Available at https://www.dcpolicycenter.org/publications/labor-force-comparison-covid-recovery/

just not in D.C. The District, which was consistently ranked among the top three places to invest across US cities before the pandemic, was ranked number 11 out of 13 in 2022.[19]

Fiscal headwinds are getting stronger.

Although COVID-19's impact on the District's residents and its economy was swift, the city's finances did not immediately suffer. The District government, along with other state and local governments, received substantial amounts of federal fiscal aid for fiscal years 2020 through 2024, allowing the city to invest in programs necessary to support its residents throughout an extremely difficult period. In the case of the District of Columbia, this meant access to $4.7 billion in federal funds in addition to direct supports received by residents and businesses.[20]

To put this in context, annual local revenue for the city has averaged $9.2 billion between fiscal years 2020 and 2024. Spread over this five-year period, the federal fiscal aid was the equivalent of 10 percent of the District's local revenue. Additionally, years of conservative revenue estimates and lower-than-expected spending left the city with substantial end-of-year surpluses which resulted in growing reserves available to future budgets. Consequently, between fiscal years 2019 and 2024, the District's own revenue is projected to grow by 17 percent, but its operating expenditures are increasing twice as fast, at 34 percent.

In the current four-year financial plan period, there is no year in which the District's own revenue is high enough to cover its local fund recurring expenditures. In fiscal year 2024, the D.C. government is planning to use $166 million in federal fiscal aid to balance its budget. In addition, the city is planning to use $756 million in other one-time money (including fund balance use and other sweeps) to support a spending level that is lower than the fiscal year 2023 level.[21] Federal fiscal aid comes to an end in Fiscal Year 2024,

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[19] AFIRE International Investor Survey, 2022.
[20] This analysis is based on data from https://www.covidmoneytracker.org. For details, see the Appendix.
[21] The actual amounts could be less. Since the enactment of the budget, the OCFO increased the revenue estimates for Fiscal Year 2023 by nearly $250 million. We will only know when the city's audit is completed, in early February.

but reliance on one-time money continues through the entire financial plan period. The city's current financial plan indicates that for fiscal year 2025, it will need $615 million in one-time funds just to maintain the same level of spending as in 2024. Heavy reliance on one-time funds continues into future years in the financial plan, with recurring revenue never reaching a point high enough to pay for recurring expenditures. While using one-time funds can be a temporary solution to fiscal distress, especially when the city has a lot of money in its reserves (as has been the case for D.C.), it cannot continue forever.

The fiscal picture is further complicated by the funding needs for WMATA, and the risky outlook for the commercial office market. As such, one of the most important challenges for the District in the coming years will be to keep spending under control.

In 2019, the D.C. Policy Center worked with the Council to set up an Expenditure Commission to examine how the city is spending its money, and whether funding is allocated to the most effective programs. Unfortunately, the Commission was never constituted, and this important work was never done. We recommend the adoption of a similar effort now. It will take multiple years to do this important work, but it can prepare the city for increasingly tougher times to come beyond Fiscal Year 2025.

There is a need for growth-oriented policies.

Research shows urban jurisdictions are more likely to recover from unexpected shocks like riots, floods, and pandemics if they have a strong and elastic housing supply, an educated workforce, and a diversified industry.[22] These points seem straightforward, but getting there requires a regulatory environment that is conducive to growth.

A stable and predictable regulatory environment is going to be particularly important for the District given its fiscal picture. Tighter budgets mean that the city will not be able

[22] Amine Ouazad (2021), "Resilient Urban Housing Markets: Shocks vs. Fundamentals." Chapter in COVID-19: Systemic Risk and Resilience, Springer Verlag, May 29, 2021. Available at https://www.clevelandfed.org/newsroom-and-events/publications/cfed-district-data-briefs/cfddb-20210301-covid-19-pandemic-urban-exodus-updates

invest as much in economic development or housing production as it did in the past. Relief could take the form of a more stable, less risky regulatory regime.

Given the importance of housing in attracting residents, the city would be well served by taking actions to reduce uncertainty around zoning requirements, site plan approvals, and permitting, which bring costly delays. Solving those problems in the context of the entire city will certainly aid Downtown redevelopment.

Furthermore, the city will also have to make difficult, and potentially unpopular, decisions. For example, affordability requirements in residential development carry a high social value but can also carry a high cost. Can the District rethink these requirements and assess the tradeoffs between the social value of affordable housing and, for example, the need for workforce housing? TOPA, which aims to reduce displacement, works well with smaller buildings, but it has deterred capital investments in new large multifamily housing development. Can the city consider limiting TOPA to smaller and older buildings with fewer units?

Similarly, First Source requirements[23] can create undue burdens without necessarily creating jobs for District residents. Recent D.C. Policy Center research found only 9 percent of the 15,200 construction workers who work in D.C. live in D.C.[24] This makes it extremely difficult to meet First Source requirements for construction projects. The District can use Downtown redevelopment to test alternative workforce plans that allow developers to invest in workforce training and receive credit towards their First Source requirements. Additionally, the District has an extremely strong network of Adult Charter Schools that prepare adults for employment in high demand jobs[25] that certainly employ

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[23] A summary of these requirements can be found here: https://does.dc.gov/sites/default/files/dc/sites/does/publication/attachments/FIRST SOURCE_Construction Factsheet.pdf
[24] Emilia Calma (2023). "Alternative Workforce Plans can help grow local talent, especially in construction where workers are lacking." Available at https://www.dcpolicycenter.org/publications/alternative-workforce-plans/
[25] Chelsea Coffin and Julie Rubin (2023). "D.C.'s adult public charter schools: Who they serve, how they serve, and what they achieve." Available at https://www.dcpolicycenter.org/publications/adult-charters/

more than 15,200 people. Can First Source requirements be replaced by contributions to such schools?

Systemic regulatory reform could be an extremely valuable tool for the District in making the city more competitive and more attractive. This is another area that the D.C. Government should consider further study and impact evaluation, which could be led by a group representing the government, the business community, and other advocates.

The District of Columbia has a super power.

The city's challenges extend beyond fiscal headwinds and regulatory impediments. D.C. has been experiencing increased crime and higher childcare costs, and its public education system continues to feel the reverberating impacts of the pandemic. These problems need more attention, but some of this attention can be delivered in the form of improved systems and better incentives, and not just tax dollars.

These are hard problems to tackle, but the District has one important advantage: it has *a single level of government* with both local level responsibilities such a schools, firefighters, and police (though public safety functions are shared with the federal government) and state level responsibilities such as public transportation, public health, and human services. In other states and cities, these functions are fragmented across multiple levels of governments. Similarly, D.C. has sole control of its tax regime, with taxing powers usually split between state and local governments.

The District's unified government can be a tremendous source of strength and competitiveness for the city; it can open doors to holistic policies that recognize interdependencies—such as those between housing, education, transportation, and economic development—and can do so without the jurisdictional tensions observed between state and local governments elsewhere. This can help the city focus on creating the right incentives for things as varied as higher population growth or stronger attendance for public school students. It can also help the city to focus on systems-level improvements like regulatory reforms and program evaluation, and deploy stronger economic development tools that can, for example, mix tax incentives with government supports, so long as the city can execute them with stronger coordination between the executive and the legislative branches.

Thank you for the opportunity to testify. I welcome any questions from the Committee.