Montgomery County Council

Committee: Joint
Committee Review: Completed
Staff: Jim Ogorzalek, Legislative Attorney
Purpose: Final action – vote expected

AGENDA ITEM #4
April 29, 2025
Action

SUBJECT

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

Lead Sponsors: Councilmembers Fani-González and Friedson

Co-Sponsors: Councilmember Luedtke, Council President Stewart, and Councilmembers Balcombe and Sayles

EXPECTED ATTENDEES

None

COUNCIL DECISION POINTS & COMMITTEE RECOMMENDATION

- The Joint Government Operations & Fiscal Policy (GO) and Economic Development (ECON) Committee recommended (6-0-1) the enactment of Expedited Bill 2-25, with amendments.
- The Council enacted Expedited Bill 2-25 by a 10-1 vote on April 8, 2025.
- The County Executive vetoed Expedited Bill 2-25 on April 21, 2025.
- Under Charter § 208, the Council may override the Executive's veto if 7 Councilmembers vote to re-enact the bill within 60 days after the Executive's disapproval.

DESCRIPTION/ISSUE

Expedited Bill 2-25 would:

(1) establish a minimum payment in lieu of taxes for certain conversions of high-vacancy commercial properties to residential use;
(2) establish the amount of the payment in lieu of taxes; and
(3) generally amend the law governing payments in lieu of taxes.

SUMMARY OF KEY DISCUSSION POINTS

None

This report contains:

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Agenda Item #4
April 29, 2025
Action

MEMORANDUM

April 24, 2025

TO: County Council

FROM: Jim Ogorzalek, Legislative Attorney

SUBJECT: Expedited Bill 2-25, Taxation – Payments in Lieu of Taxes – Affordable Housing – Amendments

PURPOSE: Action – enactment over County Executive's veto

Invited Attendees:

None

Introduction

The Council enacted Expedited Bill 2-25 on April 8, 2025. The County Executive vetoed the bill on April 21, 2025. Under § 208 of the County Charter, not later than 60 days after receiving the Executive's message of disapproval, the Council may, by the affirmative vote of seven members, enact legislation over the disapproval of the Executive.

In a letter explaining the veto, the Executive noted several policy objections to the bill as enacted, similar to the policy objections included in the Executive's previous memorandum distributed during the legislative process. The Executive's objections do not present a legal bar to re-enacting the bill.

Background

Expedited Bill 2-25, Taxation – Payments in Lieu of Taxes – Affordable Housing – Amendments, was introduced on February 4, 2025. The Lead Sponsors are Councilmembers Fani-González and Friedson. The bill's co-sponsors are Councilmember Luedtke, Council President Stewart, Councilmembers Balcombe and Sayles. Public hearings occurred on March 11, 2025, at 1:30 p.m. and 7:00 p.m. The Joint Government Operations & Fiscal Policy (GO) and Economic Development (ECON) Committee considered the bill on March 27, 2025, and recommended (6-

0-1) the enactment of the bill, with amendments. The Council enacted Expedited Bill 2-25 by a 10-1 vote on April 8, 2025.

Currently, the County Code authorizes three mechanisms by which an owner may receive the benefit of a Payment in Lieu of Taxes ("PILOT"). Montgomery County Code § 52-24(b) contains the "Standard PILOT," which permits the Finance Director to negotiate a PILOT for any qualifying housing development eligible under state law, functionally serving as local authorizing language to provide any PILOT allowed under state law. M.C.C. § 52-24(c) contains the "By Right Pilot," which requires the Finance Director to grant a minimum PILOT for certain housing developments based upon ownership or enumerated affordability requirements. M.C.C. § 52-24A allows for a PILOT for properties leased from the Washington Metropolitan Area Transit Authority.

The purpose of this bill is to expand the By Right Pilot to include an extended tax exemption period and reduced affordability requirements when the property developed is a conversion from a high-vacancy commercial use to a residential use that achieves timely approval as set forth in Sections 3.3.2.B and 7.3.5 of Chapter 59 (Zoning). As enacted, Expedited Bill 2-25 would require the Director of Finance to offer a PILOT for a residential development resulting from the conversion of a property that was designated for commercial use but had at least a 50% vacancy rate at the time of the development application to the Planning Department or Department of Permitting Services, as appropriate. To be eligible for the PILOT, the conversion of the property must comply with the requirements set forth in Section 3.3.2.B of Chapter 59 (Zoning)—which allows for demolition or adaptive reuse, contemplates multifamily or townhouse developments depending upon the context, and sets applicable timelines for approval—and provide that at least 17.5% of units be affordable to households earning 60% or less of the area median income for a period of 25 years. The Bill would require a PILOT that would exempt 100% of the real property tax that would otherwise be levied for a period of 20 years.[1]

Public hearings were held on March 11, 2025. Speakers testified both in support of and in opposition to Expedited Bill 2-25. The Council also received written testimony.[2] Testimony in support noted that Expedited Bill 2-25 would incentivize development of attainable housing and that the tax benefits of the bill would cause projects that are not currently financially viable to proceed to construction. Testimony in opposition stated that Expedited Bill 2-25 amounted to an unnecessary tax break for developers, which would not benefit County residents. Testimony expressed concerns that the bill's affordability requirement was too low. Additionally, residents were concerned about the bill's racial equity impact, as they suggested the bill would primarily benefit developers and individuals able to purchase additional market-rate housing and that the tax incentive would significantly reduce revenues used for critical public services.

[1] Expedited Bill 2-25 was introduced as part of the "More Housing N.O.W. (New Options for Workers)" package. The package includes: ZTA 25-02, Workforce Housing - Development Standards; ZTA 25-03, Expedited Approvals – Commercial to Residential Reconstruction; SRA 25-01, Administrative Subdivision – Expedited Approval Plan; and Expedited Bill 2-25, Taxation – Payments in Lieu of Taxes – Affordable Housing – Amendments.

[2] Written testimony may be found here: https://www.montgomerycountymd.gov/COUNCIL/OnDemand/testimony/20250311/item7.html.

Discussion

The County Executive vetoed Expedited Bill 2-25 because it "could significantly negatively impact County revenues, adversely affect racial equity, and provide excessive tax benefits to developers with no meaningful public benefit." The County Executive's letter to Council suggests that existing examples of conversions without subsidies demonstrate that a by-right tax abatement is not necessary to incentivize the legislation's aim. The veto letter observes that the PILOT would "represent a substantial loss to our tax base" at the same time the development would increase infrastructure needs. The Executive expressed concern that Expedited Bill 2-25 would widen housing disparities by race and ethnicity, that its 17.5% affordability requirement is insignificant compared to the lost revenue, and that the lack of a pathway to ownership in the bill would contribute to inequity. The Executive indicated that it is possible Expedited Bill 2-25 would merely shift where housing is built, as opposed to increasing the total supply of housing in the County. Echoing his letter transmitted to Council on April 3, 2025, the Executive questioned the legislative process by which Expedited Bill 2-25 was enacted and opined that "there is simply no evidence that every eligible property requires a 100% exemption from property taxes for 20 years as a matter of right," deeming the approach "fiscally irresponsible and unnecessary."

Because much of the content of the Executive's veto message reiterated what had been set forth in the letter transmitted to Council before enactment, many of the concerns raised in the message were addressed to various degrees at Council. Moreover, many of the issues raised in the veto message were addressed by the Joint GO/ECON Committee, which—similar to the discussion at Council prior to enactment—discussed the bill's impact to revenue, affordability requirement, and home ownership option. Moreover, analyses related to many of these same topics were explored in the Council Staff Comments and Questions on Bill 2-25E Fiscal Impact Statement, which was included in the April 8, 2025, Staff Report for Action by Council.

Next Step:[3] Roll call vote on whether to re-enact Expedited Bill 2-25 over the County Executive's veto.

[3] The Council authorizes Council Legislative Attorneys to make non-substantive technical corrections necessary to fix any typographical, stylistic, formatting, or grammatical errors in Bill 2-25E.

Expedited Bill No. 2-25
Concerning: Taxation – Payments in Lieu of Taxes – Affordable Housing – Amendments
Revised: 3/27/2025 Draft No. 6
Introduced: February 4, 2025
Enacted: April 8, 2025
Executive:
Effective: April 28, 2025
Sunset Date: April 27, 2035
Ch. _____, Laws of Mont. Co. _________

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

Lead Sponsors: Councilmembers Fani-González and Friedson
Co-sponsors: Councilmember Luedtke, Council President Stewart, and Councilmembers Balcombe and Sayles

AN EXPEDITED ACT to:

(1) establish a minimum payment in lieu of taxes for certain conversions of high-vacancy commercial properties to residential use;
(2) establish the amount of the payment in lieu of taxes; and
(3) generally amend the law governing payments in lieu of taxes.

By amending
Montgomery County Code
Chapter 52, Taxation
Section 52-24

Boldface	*Heading or defined term.*
Underlining	*Added to existing law by original bill.*
[Single boldface brackets**]**	*Deleted from existing law by original bill.*
Double underlining	*Added by amendment.*
[[Double boldface brackets**]]**	*Deleted from existing law or the bill by amendment.*
* * *	*Existing law unaffected by bill.*

The County Council for Montgomery County, Maryland approves the following Act:

Sec. 1. Section 52-24 is amended as follows:

52-24. Payments in lieu of taxes for certain housing developments.

(a) *Definitions*. In this Section, the following words have the following meanings.

* * *

Person has the same meaning as in Section 1-101 of the Tax-Property Article of the Maryland Code, as amended.

* * *

(c) When authorized by state law, the Director must offer a payment in lieu of taxes for a qualifying housing development:

(1) owned or controlled by the Housing Opportunities Commission that exempts 100**[**%**]** percent of the real property tax that would otherwise be levied;

(2) owned or controlled by a non-profit housing developer if at least 50**[**%**]** percent of the dwelling units located on the property receiving the payment in lieu of taxes are built under a government regulation or binding agreement with the County limiting the rent charged for the unit for at least 15 years to make the unit affordable to households earning 60**[**%**]** percent or less of the area median income. The offer must exempt 100**[**%**]** percent of the real property tax that would otherwise be levied for a period of at least 15 years, but no more than the number of years that rents charged for 50**[**%**]** percent of the dwelling units must remain restricted to households earning 60**[**%**]** percent or less of the area median income; **[**or**]**

(3) owned or controlled by a non-profit housing developer if all of the dwelling units are subject to a Section 8 Project-Based Rental Assistance Payment contract. The offer must exempt 100**[**%**]**

percent of the real property tax that would otherwise be levied as long as the Section 8 Project-Based Rental Assistance Payment contract is in effect**[.]**; or

(4) owned or controlled by a person engaged in constructing or operating housing structures or projects if:

(A) the property receiving the payment in lieu of taxes is converted to residential use from a commercial use with at least a 50 percent vacancy rate at the date of application to either the **[[**Department of Permitting Services or**]]** Planning Department or, if the property's development does not require site plan approval from the Planning Department, Department of Permitting Services under **[[**pursuant to**]]** Section 3.3.2.B of Chapter 59;

(B) the property's development meets all the requirements of an expedited approval plan under Section 7.3.5 of Chapter 59, except that if a property's development does not require site plan approval from the Planning Department it is not required to meet the requirements of an expedited approval plan but must obtain the building permit within 2 years of acceptance by the Department of Permitting Services of the building permit application that includes the core and shell of the principal building; and

(C) at least **[[**15**]]** 17.5 percent of the dwelling units located on the property are built under a government regulation or binding agreement with the County limiting the rent charged for the unit for at least 25 years to make the unit affordable to households earning 60 percent or less of the area median income.

The offer must exempt 100 percent of the real property tax that would otherwise be levied for a period of at least [[25]] 20 years beginning in the year a use and occupancy permit is issued for the qualifying development, but no more than the number of years that rents charged for [[15]] 17.5 percent of the dwelling units must remain restricted to households earning 60 percent or less of the area median income.

* * *

Sec. 2. Effective date. The Council declares that this legislation is necessary for the immediate protection of the public interest. This Act takes effect 20 days after the date on which it becomes law.

Sec. 3. Short title. This expedited bill may be cited as part of the "More Housing N.O.W. (New Options for Workers)" package.

Sec. 4. Transition. If a property has obtained site plan approval from the Planning Board by the effective date of this legislation, then the property is eligible for a payment in lieu of taxes under Section 52-24(c)(4), as amended by this Act, if it otherwise complies with subparagraphs (4)(A) and (4)(C) of Section 52-24(c), as amended by this Act, and an applicant for the property: (i) applies for a building permit, which is accepted by the Department of Permitting Services and includes the core and shell of the principal building, within 2 years of the earlier of the date of the Planning Board's resolution or the effective date of this legislation; and (ii) obtains the building permit within 2 years of acceptance by the Department of Permitting Services of the building permit application that includes the core and shell of the principal building.

Sec. 5. Sunset. This Act must sunset and must have no further force and effect after 10 years from the effective date of this legislation, except that any agreements entered into prior to the sunset must remain in full force and effect.

Approved:

Kate Stewart

April 8, 2025

Kate Stewart, President, County Council | Date

Approved:

Marc Elrich, County Executive | Date

This is a correct copy of Council action.

Sara R. Tenenbaum, Clerk of the Council | Date

OFFICE OF THE COUNTY EXECUTIVE

Marc Elrich
County Executive

MEMORANDUM

April 21, 2025

TO: Kate Stewart, President
County Council

FROM: Marc Elrich, County Executive

SUBJECT: Veto of Expedited Bill 2-25, Taxation - Payments in Lieu of Taxes - Affordable Housing - Amendments

I am vetoing Expedited Bill 2-25. This bill could significantly negatively impact County revenues, adversely affect racial equity, and provide excessive tax benefits to developers with no meaningful public benefit. My concerns about the rushed nature of this legislation and inadequate time for public input also remain unaddressed.

Let me be clear: I support converting underutilized commercial space to help provide affordable housing. However, this mechanism to achieve that goal is flawed. Projects should not automatically receive a 20-year, 100% tax abatement (elimination of all property taxes) as a matter of right. While zero evidence was presented that subsidies were even needed, we have existing examples of conversions where no subsidies were required, and pending projects that were put forward in the absence of subsidies. As Park and Planning said, "Areas such as downtown Silver Spring and Bethesda command higher rents and prices, and strong market potential for residential use shifts the conversion investment 'tipping point' toward repurposing or conversion."[1] From both fiscal and governance perspectives, the County should negotiate eligible projects on a case-by-case basis to determine whether a subsidy is needed, what benefits accrue to the County, and what the unintended consequences of a 20-year, 100% property tax abatement are.

The Fiscal Impact Statement (FIS) estimated a potential revenue loss of $2.6 billion over 25 years. While revisions to the bill since the FIS was prepared improved the outlook (20-year instead of a 25-year abatement, removing much of the retail, and ending eligibility for the program after 10 years), it will still represent a substantial loss to our tax base. While we want development and an

[1] The Third Place » Converting Office to Residential Is Complicated | MontgomeryPlanning.org

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adequate housing supply, it comes with increased infrastructure needs – schools, transportation, public safety, parks, recreation, and more, all of which we have struggled to provide because of a lack of tax revenue needed to fund adequate operating and capital budgets. When developers do not contribute their share of costs, they will ultimately be shifted to our residents and other businesses. Given other increased costs anticipated this fiscal year and economic uncertainty at the federal level that could affect our housing market, I cannot justify supporting this rushed proposal with such significant financial implications. This is the last thing we should be doing now.

The market is already addressing conversions without County subsidies. Silver Spring has seen multiple conversions without this kind of subsidy, including the Guardian apartments, which added five stories and created 178 new residential units, the Elon at 700 Roeder Road, and the Octave – all without tax abatements. Additionally, the Department of Housing and Community Affairs (DHCA) currently uses PILOTs as a negotiation tool to secure higher percentages of affordable units and broader income accessibility than would otherwise be built.

The market has also already addressed vacancies in other ways. If a project is underwater, the owner or developer can walk away, and that particular LLC is finished. No payback is required for lost or future rents, and the same developer can develop new projects with no liability from the old project. When the bank regains the property, it puts it on the market at a price the market can bear, and the building is re-tenanted.

Another market mechanism we have seen address vacancies is when developers sell a building at market value, pay the bank what they receive, and walk. The bank resells, and the new owner then puts the building on the market at rents that attract tenants. This bill is nothing more than a developer relief act. There are market mechanisms that address their problems, and our residents should not have to pay to fix them.

We should also consider that the optimal outcome for commercial buildings is full business occupancy, which grows our tax base rather than reducing it. It is not evident that we should prioritize diminishing the inventory of potential business locations in Montgomery County, particularly as we work to strengthen our economic development. We want businesses to have a variety of choices when locating here.

Furthermore, the Office of Racial Equity and Social Justice has determined that Bill 2- 25E would likely widen housing disparities by race and ethnicity. With the Council's amendment, only 17.5% of new units would be designated affordable, and none would be ownership opportunities. Homeownership remains the primary pathway to wealth accumulation, yet homeownership rates are significantly lower for Black and Hispanic households (42.5% and 49.1%, respectively) than for white and Asian households (73.2% and 74.3%). This bill does nothing to address this fundamental inequity.

Additionally, the 17.5% MPDU requirement is insignificant given the high cost of this bill. We do not pay this amount to get this number of additional MPDUs. This bill also makes no provisions for workforce housing, even though the sponsors of the More Housing Now package have raised that as an urgent need.

Additionally, there is no evidence that this will increase the total supply of housing; it is just as likely to shift where the housing is built. There are currently approximately 30,000 units that have been approved by the Planning Board and could be built as soon as a permit is pulled; those projects are far along already. This is also not a static number—different projects are approved and built, and others get added to the pipeline.

The process for this legislation is also concerning. The bill was introduced on February 4, with a Planning review on March 6 and a public hearing on March 11—all for a complex housing package with significant implications for County revenue and development patterns. This compressed schedule did not allow sufficient time for thorough review by residents, stakeholders, or the executive branch. The numerous opposition testimonies submitted for this bill underscore this problem.

As I have stated previously and reiterate here, there is simply no evidence that every eligible property requires a 100% exemption from property taxes for 20 years as a matter of right. Such a sweeping approach is fiscally irresponsible and unnecessary.

I remain committed to working with the Council to develop more targeted, fiscally responsible alternatives that can convert appropriate commercial properties into sustainable and affordable housing that truly serves our diverse community. I hope you will reconsider your vote and sustain this veto so that we can have more complete conversations to achieve that balance missing from Expedited Bill 2-25E.

OFFICE OF THE COUNTY EXECUTIVE

Marc Elrich
County Executive

April 3, 2025

Kate Stewart, Council President
Montgomery County Council
100 Maryland Avenue, 6th Floor
Rockville, MD 20850

Dear Council President Stewart,

I write to urge you not to take a final vote next week on Expedited Bill 2-25 as amended at the session of the joint committees of Government Operations and Fiscal Policy and Economic Development.

As you know, Bill 2-25E would give an automatic abatement of property taxes to certain developers who convert or demolish a 50% vacant commercial building and turn it into a residential building. The developer would not pay any property taxes for 20 years via a Payment in Lieu of Taxes (PILOT). I want to be clear: I have no objection to conversion of office to residential properties, and no problem helping facilitate that within zoning and height regulations. I object to an automatic by-right exemption of 100% of property taxes for 20 years without regard to the details and financing of a particular project.

Here are the issues and questions that I am asking that you consider.

What is the need?

I understand that the Economic Development committee has reviewed the issue of office vacancies; I would ask that the packet include the links to the reports and analyses and any relevant summaries. It would be helpful to understand the existing problem and obstacles. Additionally, DHCA currently uses PILOTs successfully to negotiate for a higher percentage of affordable units or availability to a wider range of incomes. These negotiations have produced a much greater number of affordable units than otherwise would have been built.

Is the cost worth it?

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The market takes care of some of these issues already. Here are examples of three different ways that the market is working – without county subsides or tax exemption:

1. A building goes back to the bank. The bank then sells it at foreclosure for a greatly reduced price. This happened with the Discovery building in Silver Spring.
2. The owner/developer sells the building at a dramatically reduced price from where they bought it (likely because the loan is no longer worth it). This happened at a building in Bethesda at Wisconsin and Old Georgetown.

In both the above cases, the buyer has the property at a price that allows them to redevelop and charge the rents they want.

3. The market worked for a property owner to convert an office to residential in Silver Spring. The project, the Guardian, added 5 stories and 75,000 square feet, and it produced 178 new residential units were created. <u>There was no county subsidy.</u> The Bank would have only lent the money only if the project penciled out.

Which brings me to the next question:

Is this fair? For developers? For others?

The above example of the Guardian illustrates that an automatic (by-right) PILOT could disadvantage other property owners who have recently undergone a conversion. Additionally, property owners/developers who are producing housing but not eligible for a conversion PILOT are at a disadvantage for no public benefit. It does not make financial sense to authorize automatic payments to private developers that could potentially cost the county billions of dollars in lost revenues and disadvantage other developers and property owners.

Furthermore, this bill has a negative racial equity analysis. As has been noted by the Racial Equity and Social Justice analysis by the Council's Office of Legislative Oversight Office, Bill 2-25E could "widen disparities in housing by race and equity." (https://www.montgomerycountymd.gov/OLO/Resources/Files/resjis/2025/Bill2-25E.pdf pg. 1)

Additionally, this bill does not prioritize homeownership or affordability. Only 17.5% of the new units would need to be designated affordable, and they would all be rental. Homeownership is the most important path to wealth accumulation, and homeownership levels are much lower for black and Hispanic households (42.5% and 49.1% respectively as compared to 73.2% and 74.3% for white and Asian households.[1]).

And this is not good for county revenues. As the Fiscal Impact Statement pointed out, it represents a large loss of revenue. The fiscal impact statement estimated $2.6 billion over 25

[1] "RACIAL EQUITY PROFILE MONTGOMERY COUNTY," Jupiter Independent Research Group, June 2019, pg. 29. Microsoft Word - Cover Page 2019-7.docx

years - the actual amount is different given the changes made at committee, but it will still be substantial. Revenue not provided by development is paid by someone else, often residents.

Process: has this proposal been sufficiently vetted?

I have raised questions above that deserve a greater discussion. I understand that there has been a public hearing, but the public hearing was for the entire More Housing NOW package, which included two ZTAs as well as this Bill, and the time between the introduction of the housing package and the public hearing was quick: introduction was February 4, Planning review was March 6, and the public hearing was March 11 – for the entire package. Residents – and executive branch – did not have sufficient time to review all of the proposals thoroughly. People remained confused about the proposals and what they would do.

Conclusion

We are at moment of enormous uncertainty at the federal level; we do not know what the federal cuts will mean to the housing market here. There is no urgency to pass this bill immediately, but there is a necessity to pause and consider possible unintended consequences.

The actual best outcome for commercial buildings is to be re-tenanted with businesses – we need to grow our tax base. It is not clear that we want to prioritize reducing the number of places businesses could locate. That may not be in the county's best economic interest, and it may not be necessary, which is why these situations need to be examined on a case-by-case basis.

There is no evidence that every eligible property needs 100% exemption from property taxes for 20 years. Consequently, I ask that Council continue to deliberate on this proposal and postpone a vote until after it is more thoroughly considered.

Sincerely,

Marc Elrich
County Executive

cc: Montgomery County Councilmembers
Craig Howard, Executive Director, Montgomery County Council
Livhu Ndou, Senior Legislative Attorney, Montgomery County
Jim Ogorzalek, Legislative Attorney, Montgomery County

MONTGOMERY COUNTY COUNCIL

ROCKVILLE, MARYLAND

January 28, 2025

Colleagues:

For your consideration, we are enclosing the details of an ambitious workforce housing package which takes five steps to increase the supply of housing, drive down costs, and increase pathways to homeownership for the hard-working residents of Montgomery County.

With the high cost of housing squeezing families and holding back our economy, the **More Housing N.O.W. (*New Options for Workers*)** package helps build more homes that are affordable to teachers, firefighters, police officers, biotech and healthcare workers, and everyone in, or striving to be in, the middle class.

Homes are too expensive in Montgomery County. We all know it. Consider the following figures:

- Not only are we starting from a high level, but it's getting increasingly expensive. Housing price increases have outpaced inflation and income growth since the mid-1990s.
- Between 2023 and 2024, the average sold price across all unit types increased by 6.5%, while wages have only increased by 1.5%
- In 2024, the average sale price for a single family detached home was $1.02 million. To afford this house, a couple would need a combined income of approximately $340,000, far exceeding Montgomery County's area median income for a couple at $123,800. Townhomes, which are on average smaller than detached units, sold for an average of $583,000. A couple would need a combined income of $197,000 to afford this house.

Working families and young professionals are feeling the squeeze. According to the Comptroller of Maryland's 2024 State of the Economy Report, housing affordability and availability is hurting efforts to attract new residents who could fill job vacancies, noting "prospective businesses turning down potential location plans to Maryland due to insufficient workforce housing." Similarly, a recent supply/demand analysis by the Montgomery Planning Department, we are facing a deficit of over 12,000 rental units that are affordable to incomes at 70-120% of area median income (AMI). This forces these workers to swallow exorbitant housing costs *or* compete with residents at lower income bands for less expensive options. Both are bad outcomes.

The status quo is unsustainable and makes our County less attractive to families, workers, entrepreneurs, and businesses.

To address this crisis, we must act boldly. Now.

The More Housing N.O.W. package takes five bold steps to increase housing supply, reduce costs, and expand pathways to homeownership for hardworking Montgomery County residents:

Building More Workforce Housing

1. **Workforce Housing ZTA**: Allow more residential building types along corridors with a workforce housing requirement
    a. Allow more residential building types through optional method development along corridors with a 15% workforce housing requirement in the R-200, R-90, R-60, and R-40 zones.
    b. Corridors included are Boulevards, Downtown Boulevards, Downtown Streets, Controlled Major Highways, and Town Center Boulevards that have a master planned width greater than 100 feet and 3+ existing travel lanes
    c. Density capped at 1.25 FAR
    d. Maximum height is 40 feet
    e. Require 15% of units satisfy the definition of workforce housing, with a minimum of 1 workforce housing unit for structures that have 3 or more units
    f. Maintain existing workforce housing definition of 120% AMI, which is currently approximately $148,000 for 2 persons or $185,000 for a family of four
2. **Workforce Housing Opportunity Fund:** New countywide fund to incentivize the construction of workforce units
    a. $4 million in initial funding

b. Eligible projects must provide at least 30% workforce units
c. Workforce units must be affordable to 80% AMI (area median income), on average

Converting Highly Vacant Office to Housing

3. **Office to Housing ZTA:** Create an expedited approval process for projects that convert high-vacancy commercial properties to residential use
    a. Applies to the Commercial-Residential, NR, and EOF zones
    b. Retail or office building that is at least 50% vacant
    c. Remove residential restriction on FAR, so that total commercial-residential FAR can be used for residential
    d. In red policy areas, must be for the apartment-building type; may include townhomes outside of the red policy area
    e. Must pull a building permit within 2 years of approval
4. **Office to Housing PILOT Bill:** Establish a payment in lieu of taxes (PILOT) for conversion of high-vacancy commercial properties to residential use
    a. Retail or office building that is at least 50% vacant
    b. 100% tax abatement for 25 years for qualifying projects
    c. Minimum 15% MPDU requirement

Pathways to Homeownership

5. **Budget:** Double the County's investment in the Homeowner Assistance Program from $4 million to $8 million in the FY26 Housing Initiative Fund (HIF)
    a. Funds may be used in partnership with the State's Maryland Mortgage Program (which allows the household to receive both down payment assistance and lower rate mortgage) and through the Housing Opportunities Commission's Montgomery County Homeownership Assistance Fund (McHAF).
    b. Up to $25,000 may be granted to a first-time buyer thus providing support for up to 160 qualified applicants. Up to $1.0 million is reserved for County and MCPS employees under the Montgomery Employee Down Payment Assistance Loan (MEDPAL)

Many thanks to Council President Kate Stewart, Councilmembers Dawn Luedtke, Marilyn Balcombe, and Laurie-Anne Sayles who have already signed on as co-sponsors as well as the many community advocates and housing experts for their strong support of this package which we will be unveiling today at noon. We would welcome additional cosponsors prior to introduction of the legislative aspects of the package, scheduled for February 4.

We have appended the zoning text amendments, legislation, and some supporting materials to assist your review of the proposal. We appreciate your thoughtful consideration of this package and hope to earn your support for it in the coming weeks and months.

Our housing crisis is a serious and urgent matter. There is no time to wait.

Sincerely,

Andrew Friedson
Councilmember, District 1

Natali Fani-González
Councilmember, District 6

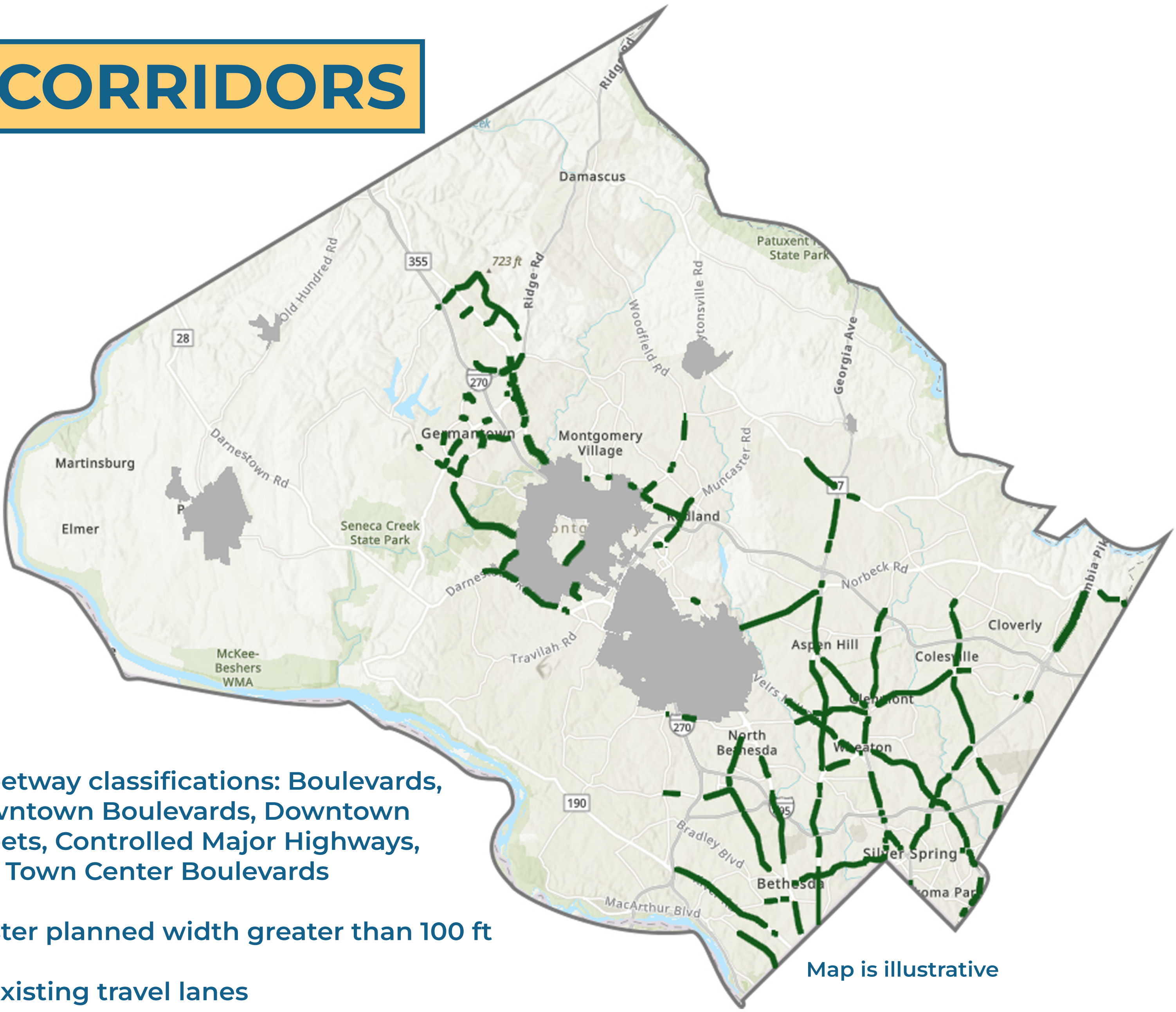
Attachments:

1. Workforce Housing ZTA Corridors Map
2. Workforce Housing ZTA
3. Office to Housing ZTA
4. Office to Housing Pilot Bill

More Housing N.O.W.

New Options for Workers

CORRIDORS



Streetway classifications: Boulevards, Downtown Boulevards, Downtown Streets, Controlled Major Highways, and Town Center Boulevards

Master planned width greater than 100 ft

3+ existing travel lanes

Map is illustrative

Racial Equity and Social Justice (RESJ) Impact Statement

Office of Legislative Oversight

EXPEDITED BILL 2-25: TAXATION – PAYMENTS IN LIEU OF TAXES – AFFORDABLE HOUSING – AMENDMENTS

SUMMARY

The Office of Legislative Oversight (OLO) anticipates Expedited Bill 2-25 could have a negative impact on racial equity and social justice (RESJ) in the County. Bill 2-25 would likely benefit landlords and residents who can afford market-rate housing more than residents in need of affordable housing. Therefore, OLO anticipates this Bill could widen disparities in housing by race and ethnicity. Further, the forgone property tax revenue from this Bill could undermine the County's ability to provide future public goods and services, which could particularly harm BIPOC community members. OLO offers one policy option for Council consideration.

PURPOSE OF RESJ IMPACT STATEMENTS

RESJ impact statements (RESJIS) evaluate the anticipated impact of legislation on racial equity and social justice in the County. RESJ is a **process** that focuses on centering the needs, leadership, and power of Black, Indigenous, and other people of color (BIPOC) and communities with low incomes. RESJ is also a **goal** of eliminating racial and social inequities. Applying a RESJ lens is important to achieve RESJ.[1] This involves seeing, thinking, and working differently to address the racial and social inequities that cause racial and social disparities.[2]

PURPOSE OF EXPEDITED BILL 2-25

The County's Payment in Lieu of Taxes (PILOT) program aims "to support the construction and preservation of affordable multifamily rental housing" in the County.[3] A PILOT lowers or completely abates County real property taxes on affordable rental housing projects for a set period of time. The County offers three PILOT options. Specifically, the By Right PILOT option abates all County real property taxes for at least 15 years if:[4]

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

The purpose of Bill 2-25 is to expand the By Right PILOT option to provide tax abatements to commercial buildings that are converted to residential buildings primarily comprised of market-rate units. A property owner could qualify for a By Right PILOT if:[5]

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

Property owners who qualify for this PILOT program would be exempt from 100 percent of County real property taxes for 25 years.[6]

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

In October 2024, OLO previously published a RESJIS for Bill 18-24, Housing Policy – Standards and Procedures – Amendments.[7] Please refer to this RESJIS for background on housing affordability and racial equity.

ANTICIPATED RESJ IMPACTS

Affordable housing development. As described in the RESJIS for Bill 18-24, historical and contemporary racial inequities drive increased demand in affordable housing among Black and Latinx families in the County.[8] As shown in Table B (Appendix), the median incomes of Black and Latinx households are each more than $30,000 less than the median income of all households in the County. Further, Black community members are largely overrepresented among families who live in properties owned by the County's largest affordable housing provider, the Housing Opportunities Commission (HOC).[9]

To qualify for the By Right PILOT, Bill 2-25 requires property owners to comply with certain zoning requirements. These zoning requirements were recently introduced with ZTA 25-03. If enacted, ZTA 25-03 would create an expedited approval process for property owners to convert vacant commercial buildings into residential buildings.[10] Commercial-to-residential conversion projects enabled by ZTA 25-03 would be subject to the County's Moderately Priced Dwelling Units (MPDUs) requirements. MPDUs are housing units that are affordable to renters and first-time home buyers making up to 70 percent of the AMI.[11] In housing developments with more than 20 units, between 12.5 to 15 percent of the units must be MPDUs.[12] The percentage of required MPDUs depends on where the housing development is located.

In terms of affordable housing, ZTA 25-03 and Bill 2-25 create two options for property owners who want to convert vacant commercial buildings into residential buildings:

- **Convert without a By Right PILOT:** At least <u>12.5 percent</u> of the units in the building must be affordable to households making up to <u>70 percent</u> of the AMI.
- **Convert with a By Right PILOT:** At least <u>15 percent</u> of the units in the building must be affordable to households making up to <u>60 percent</u> of the AMI.

Thus, the By Right PILOT created by Bill 2-25 would encourage property owners to provide a slightly larger percentage of MPDUs that are slightly more affordable. Of note, researchers have recognized that office conversion projects are "economically challenging and often not possible without significant public funding."[13] Thus, the By Right PILOT could also incentivize the development of housing and accompanying MPDUs that would otherwise not occur.

Additional impacts by race and ethnicity. To consider the anticipated impact of Bill 2-25 on RESJ in the County, OLO recommends further consideration of two related questions:

- Who would primarily benefit or be burdened by this bill?
- What racial and social inequities could passage of this bill weaken or strengthen?

Several stakeholders could benefit from the By Right PILOT – the 25-year property tax exemption – created through Bill 2-25:

- **Landlords who rent out units in converted buildings** would benefit from decreased operating costs and increased profits from owing no property taxes. Table A (Appendix) shows data on business ownership in the local real estate and rental and leasing sector by race and ethnicity. The data suggests White people are largely overrepresented among landlords and other real estate business owners in the County. Meanwhile, Black, Latinx, and to a lesser extent, Asian people, are underrepresented.
- **Community members who rent units in converted buildings** could also benefit from decreased rents charged by landlords. This would likely benefit community members who rent market rate units. Landlords are unlikely to lower rents further than the required guidelines for community members living in affordable units. According to Zillow, the average rent in the County is $2,273.[14] Considering the cost burden threshold (spending more than 30 percent of income on housing costs), this rent would be affordable to households making at least $90,920 per year. Table B (Appendix) shows data on median household income in the County by race and ethnicity. The data shows the median income of Black households is lower than this threshold, while the median income of Latinx households is slightly above this threshold. Conversely, the median incomes of White and Asian households is well above this threshold. Thus, White and Asian households in the County are better positioned to afford market rate units.
- **Homeowners who purchase units in converted buildings** would benefit from decreased housing costs from owing no property taxes. This would benefit homeowners of affordable and market rate units. Table C (Appendix) shows homeownership rates in the County by race and ethnicity. The data suggests White and Asian community members in the County are more likely to be homeowners. Meanwhile, Black and Latinx community members are less likely to be homeowners.

Conversely, **County constituents at large** would be burdened by 25 years of forgone property tax revenue from the converted buildings. Property taxes are the largest source of tax revenue for the County government.[15] The forgone revenue would undermine the County's ability to provide public goods and services, especially with the increased demand from community members who are moving into the converted buildings. The resource limitations could particularly harm BIPOC community members, especially as they continue to become a larger part of the population.

Conclusion. OLO anticipates Bill 2-25 could have a negative impact on RESJ in the County. Bill 2-25 could incentivize the development of housing and MPDUs that may not otherwise occur without public funding. However, OLO anticipates this incentive will primarily benefit landlords and residents who can afford market-rate housing rather than residents in need of affordable housing. Given the demographics of households who can afford market-rate housing units compared to affordable units, OLO anticipates this Bill could widen housing disparities by race and ethnicity. Further, the forgone property tax revenue from tax abatements that primarily subsidize the development of market rate units could undermine the County's ability to provide future public goods and services. This could particularly harm BIPOC community members.

RECOMMENDED AMENDMENTS

The Racial Equity and Social Justice Act requires OLO to consider whether recommended amendments to bills aimed at narrowing racial and social inequities are warranted in developing RESJ impact statements.[16] OLO anticipates Expedited Bill 2-25 could have a negative impact on RESJ in the County. Should the Council seek to improve the RESJ impact of this Bill, OLO offers one policy option for Council consideration:

- **Consider financial incentives for commercial-to-residential conversion projects that increase the yield of affordable housing units.** Tax abatements that increase the supply of market-rate units primarily benefit White-owned businesses and higher income White and Asian community members. Encouraging the development of more affordable housing that benefits lower-income Black and Latinx community members increasingly helps to offset this impact and narrow disparities in housing by race and ethnicity. Communities throughout the U.S. are experimenting with different financial incentives that can provide more affordable housing through office-to-residential conversions.[17] For instance, incentive programs in Pittsburgh and Chicago are aiming for 20 to 30 percent of units in publicly supported conversion projects to be affordable.[18] The Council could consider programs such as these or amendments to the proposed By Right PILOT that would provide a higher percentage of affordable housing units.

CAVEATS

Two caveats to this racial equity and social justice impact statement should be noted. First, predicting the impact of legislation on racial equity and social justice is a challenging analytical endeavor due to data limitations, uncertainty, and other factors. Second, this RESJ impact statement is intended to inform the legislative process rather than determine whether the Council should enact legislation. Thus, any conclusion made in this statement does not represent OLO's endorsement of, or objection to, the bill under consideration.

CONTRIBUTIONS

OLO staffer Janmarie Peña, Performance Management and Data Analyst, drafted this RESJ impact statement.

APPENDIX

Table A: Percent of Real Estate and Rental and Leasing Business Owners by Race and Ethnicity, Montgomery County

Race and ethnicity[19]	Real Estate and Rental and Leasing Business Owners (NAICS 53)[20,21]	Population
Asian	12.4	15.3
Black	5.1	18.5
White	82.3	46.6
Latinx	3.9	20.0

Source: 2022 American Business Survey (Table AB2200CSA01) and 2022 American Community Survey 5-Year Estimates (Table DP05), Census Bureau.

Table B: Median Household Income by Race and Ethnicity, Montgomery County

Race and ethnicity	Median Household Income
County	$125,371
Asian	$143,911
Black	$86,359
White	$160,756
Latinx	$92,050

Source: 2023 American Community Survey 1-Year Estimates (Table S0201), Census Bureau.

Table C: Homeownership Rate by Race and Ethnicity, Montgomery County

Race and ethnicity	Homeownership Rate
County	64.4
Asian	75.1
Black	43.9
White	74.4
Latinx	48.8

Source: 2023 American Community Survey 1-Year Estimates (Table S0201), Census Bureau.

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[1] Definition of racial equity and social justice adopted from Marlysa Gamblin et al., "Applying Racial Equity to U.S. Federal Nutrition Programs," Bread for the World and Racial Equity Tools.
[2] Ibid.
[3] Payment in Lieu of Taxes (PILOT), Department of Housing and Community Affairs.
[4] Ibid.
[5] Introduction Staff Report for Expedited Bill 2-25, Montgomery County Council, introduced February 4, 2025.
[6] Ibid.
[7] RESJIS for Bill 18-24, Office of Legislative Oversight, October 3, 2024.
[8] Ibid.
[9] Ibid.
[10] Introduction Staff Report for Zoning Text Amendment 25-03, Montgomery County Council, Introduced February 4, 2025.
[11] MPDU Program – General, Department of Housing and Community Affairs.
[12] MPDU Developers, Department of Housing and Community Affairs.
[13] Tracey Hadden Loh et al., "Myths about converting offices into housing—and what can really revitalize downtowns," Brookings, April 27, 2023.
[14] Montgomery County, MD Housing Market, Zillow.
[15] FY25 Approved Taxes, Revenues, Montgomery County Operating Budget.
[16] Bill 27-19, Administration – Human Rights – Office of Racial Equity and Social Justice – Racial Equity and Social Justice Advisory Committee – Established, Montgomery County Council
[17] Michela Zonta et. al, "Converting Vacant Office Space Into Housing," Center for American Progress, July 30, 2024.
[18] Ibid and LaSalle Corridor Revitalization, City of Chicago.
[19] Estimates for Native American and Pacific Islander community members were not available for data points in this RESJIS.
[20] The Real Estate and Rental and Leasing Sector includes establishments that rent, lease, or otherwise allow the use of their own real estate or other assets by others. This sector also includes establishments primarily engaged in managing real estate for others, selling, renting, and/or buying real estate for others, and appraising real estate.
[21] Margins of error for these data points may be large.

Climate Assessment

Office of Legislative Oversight

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

Summary

The Office of Legislative Oversight (OLO) anticipates Expedited Bill 2-25 could have a small, positive impact on the County's community climate resilience and the County's contribution to greenhouse gas emissions as the proposed change is intended to expand a County program that supports the construction and preservation of affordable multifamily rental housing. Further, the Bill encourages the conversion of existing commercial buildings to residential which is a more sustainable construction practice than demolishing and rebuilding. However, only a small number of existing County buildings would be eligible for conversion from commercial to residential, which the proposed tax abatement targets, therefore it is unlikely a significant number of affordable housing units would be created from the proposed change nor significantly decrease the amount of County greenhouse gas emissions associated with development.

Background and Purpose of Expedited Bill 2-25

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

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

The purpose of Bill 2-25 is to expand the By Right PILOT option to provide tax abatements to commercial buildings that are converted to residential buildings primarily comprised of market-rate units. A property owner could qualify for a By Right PILOT if:[3]

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

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

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

ANTICIPATED IMPACTS

This Bill is part of a package of proposed housing measures, called the More Housing N.O.W. (New Options for Workers)".[5] The ZTAs and SRAs are meant to increase access to affordable housing and targets the development of new affordable housing along transit corridors, which would allow more access to public transit options for more individuals living and working in the County.[6] Further, for individuals who would elect to drive, living closer to work would cut down on both commute times and individual contributions to greenhouse gas emissions by driving fewer miles.[7]

Bill 2-25's proposed actions are intended to incentivize developers and landlords to set aside units that are affordable to households making up to 60% of the area median income by abating all County real property taxes for up to 15 years. This would expand the existing By Right PILOT program to apply to commercial buildings with high vacancy (at least 50%) that would be converted into residential housing and would set aside at least 15% of the units for affordable housing.[8]

The affordability of a community's housing stock has a direct correlation to the overall resilience of a community, and on its ability to prepare for current and future risks.[9] It can do so through two ways:

- Increasing housing stability which can increase community resilience by building community ties and enabling residents to stay better connected during emergencies; and
- Alleviating cost-burdened households by providing more affordable housing options, which allows these households to have more cash on hand to weather shocks, such as extreme weather events.[10]

According to data presented on March 11, 2024 by the Montgomery County Economic Development Corporation (MCEDC), there is an estimated 1% of County buildings with high vacancies that would be feasible to convert from offices to housing. It was further noted that in a strong office market, office rents generally yield higher rents compared to residential so developers are hesitant to convert.[11] Another 6.5% of commercial office buildings would be good candidates for demolition, and depending on zoning, residential housing could be built on the previous site.[12] Due to the small percentage of currently eligible buildings for conversion and the uncertainty of the type of building that would be built following demolition, it is not likely that the proposed actions would significantly increase the amount of affordable housing units in the County.

Further, as the Bill would encourage the conversion of existing high vacancy office buildings to residential homes, the resulting construction would be less carbon intensive than demolishing and rebuilding on an existing site. This is due to embodied carbon, which represents the total carbon emissions released during the lifecycle of building materials and includes emissions associated with manufacturing building materials, transportation of materials, and disposal of materials.[13] The building sector is responsible for at least 37% of global greenhouse gas emissions and sustainable building practices, such as renovating existing office buildings to residential buildings, saves the embodied carbon that was used for the initial build.[14] However, as only an estimated 1% of County buildings are feasible to convert from offices to housing, it is unlikely the proposed actions would significantly decrease the amount of County greenhouse gas emissions associated with development.[15]

As Bill 2-25 proposes changes that could create a small number of affordable housing units and encourage more sustainable construction practices, OLO anticipates the Bill could have a small, positive impact on the County's community climate resilience and the County's contribution to greenhouse gas emissions.

Recommended Amendments

The Climate Assessment Act requires OLO to offer recommendations, such as amendments or other measures to mitigate any anticipated negative climate impacts.[16] OLO does not offer recommendations or amendments as Bill 2-25 is likely to have a small positive impact on the County's contribution to addressing climate change, including the reduction and/or sequestration of greenhouse gas emissions, community resilience, and adaptative capacity.

Caveats

OLO notes two caveats to this climate assessment. First, predicting the impacts of legislation upon climate change is a challenging analytical endeavor due to data limitations, uncertainty, and the broad, global nature of climate change. Second, the analysis performed here is intended to inform the legislative process, not determine whether the Council should enact legislation. Thus, any conclusion made in this statement does not represent OLO's endorsement of, or objection to, the bill under consideration.

PURPOSE OF CLIMATE ASSESSMENTS

The purpose of the Climate Assessments is to evaluate the anticipated impact of legislation on the County's contribution to addressing climate change. These climate assessments will provide the Council with a more thorough understanding of the potential climate impacts and implications of proposed legislation, at the County level. The scope of the Climate Assessments is limited to the County's contribution to addressing climate change, specifically upon the County's contribution to greenhouse gas emissions and how actions suggested by legislation could help improve the County's adaptative capacity to climate change, and therefore, increase community resilience.

While co-benefits such as health and cost savings may be discussed, the focus is on how proposed County bills may impact GHG emissions and community resilience.

CONTRIBUTIONS

OLO staffer Kaitlyn Simmons drafted this assessment.

[1] Payment in Lieu of Taxes (PILOT), Department of Housing and Community Affairs.
[2] Ibid.
[3] Introduction Staff Report for Expedited Bill 2-25, Montgomery County Council, introduced February 4, 2025.
[4] Ibid.
[5] Councilmembers Andrew Friedson and Natali Fani-González unveil More Housing N.O.W. package, Montgomery County Government, January 28, 2025.
[6] Legislation would allow duplexes, triplexes along MoCo transit corridors, Bethesda Magazine, January 28, 2025.
[7] What You Can Do to Reduce Pollution from Vehicles and Engines, U.S. EPA, Accessed 2/24/2025.
[8] Introduction Staff Report for Expedited Bill 2-25, Montgomery County Council, introduced February 4, 2025.
[9] The Community Resilience Benchmarks, Alliance for National and Community Resilience, Accessed 2/24/2025.
[10] Equitable Adaptation Legal & Policy Toolkit: Resilient Affordable Housing, Anti-Displacement, and Gentrification, Georgetown University Climate Center, Accessed 2/24/2025.
[11] Economic Development Committee Worksession - Office Vacancy Follow-up, Montgomery County Government, March 6, 2024.
[12] Economic Development Committee Worksession - Office Vacancy Follow-up, Montgomery County Government, March 6, 2024.
[13] C-MORE: Construction Material Opportunities to Reduce Emissions, U.S. EPA, Accessed 2/24/2025.
[14] Building Materials and the Climate: Constructing a New Future, UN Environment Programme, September 2023.; Embodied Carbon and the Nuances in Office-to-Residential Conversions, Gavu, E.K. and Peiser, R.B., *Sustainability*, January 26, 2024.
[15] Economic Development Committee Worksession - Office Vacancy Follow-up, Montgomery County Government, March 6, 2024.
[16] Bill 3-22, Legislative Branch – Climate Assessments – Required, Montgomery County Council, Effective date October 24, 2022

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

SUMMARY

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

BACKGROUND AND PURPOSE OF EXPEDITED BILL 2-25

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

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

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

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

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

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

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

INFORMATION SOURCES, METHODOLOGIES, AND ASSUMPTIONS

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

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

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

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

No formal methodologies or assumptions are used in this analysis.

VARIABLES

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

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

IMPACTS

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

Businesses, Non-Profits, Other Private Organizations

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

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

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

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

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

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

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

Residents

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

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

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

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

Net Impact

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

DISCUSSION ITEMS

Not applicable

CAVEATS

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

AUTHOR

Stephen Roblin (OLO) prepared this report.

Fiscal Impact Statement

Office of Management and Budget

Bill 2-25E	**Taxation - Payments in Lieu of Taxes - Affordable Housing - Amendments**
Bill Summary	This bill expands payment in lieu of taxes (PILOT) to housing developments if the property meets the following criteria: the property has been converted from commercial use to residential use; the property has at least a 50 percent vacancy rate at the time of application; the property's development meets all the requirements of an expedited approval plan under County Code; and at least 15 percent of the units are built under a government regulation or binding agreement limiting the rent charged for the unit for at least 25 years, to ensure the unit is affordable for households earning 60 percent or less of the Area Median Income (AMI). The bill provides a real property tax exemption for at least 25 years from when the use and occupancy permit is issued, however the exemption ends if less than 15 percent of the units limit rent to ensure the unit is affordable for households earning 60 percent or less of the AMI.
Fiscal Impact Summary	The bill adds 1.0 FTE for a Senior Planning Specialist and $134,600 in personnel costs to the Department of Housing and Community Affairs (DHCA) Multifamily Housing Program. Operating expenses needed to support the position increase by $7,500 in FY26 and $1,700 each year thereafter. The Department of Finance estimates real property tax revenues could decrease by approximately $5.8 million in the first year, increasing by further annual reductions of an additional $6-7 million as more properties utilize the PILOT, resulting in a loss of $130 million in real estate tax revenue in the six-year analysis period. Assuming the PILOT is provided to qualifying properties for no more than 25 years, Finance estimates the annual decrease in property tax revenues will continue to grow for 25 years from the time the initial projects received the PILOT, after which new PILOTs may replace expired PILOTs and the revenue decrease stabilizes with annual loss of around $230 million in property tax revenue per year, with total loss over that 25-year period of approximately $2.6 billion.

Fiscal Year	**26**	**27**	**28**	**29**	**30**	**31**	**Total**
Personnel Costs	$134,600	$134,600	$134,600	$134,600	$134,600	$134,600	$807,600
Operating Expenses	$7,500	$1,700	$1,700	$1,700	$1,700	$1,700	$16,000
Total Expenditures	**$142,100**	**$136,300**	**$136,300**	**$136,300**	**$136,300**	**$136,300**	**$823,600**
Revenues	**($5,795,200)**	**($11,822,300)**	**($18,088,100)**	**($24,599,800)**	**($31,364,700)**	**($38,390,400)**	**($130,060,500)**
Total Impact	**($5,937,300)**	**($11,958,600)**	**($18,224,400)**	**($24,736,100)**	**($31,501,000)**	**($38,526,700)**	**($130,884,100)**
FTE	1.00	1.00	1.00	1.00	1.00	1.00	

Fiscal Impact Analysis

Expenses

DHCA indicates that it will require 1.0 FTE for a Senior Planning Specialist, which creates $134,600 in new personnel costs each year. The position also requires one-time operating expenses of $5,900 for equipment and furniture, and ongoing operating expenses of $1,700 for software licenses and basic supplies.

	Revenues This analysis estimates this bill will result in a $5.8 million decrease in real property tax revenues from projected FY26 levels, with that reduction increasing by a further $6-7 million annually as the number of properties utilizing the PILOT benefit increases over time. This analysis anticipates the revenue impact on projections assuming: • a property tax rate of $1.0255 per $100 in taxable assessed value (should the rate increase, the amount of revenue lost would commensurately increase); • new multifamily development adds $5.5 million in new real property tax revenues annually; • senior apartment developments add an additional $300,000 in new real property tax revenue annually; and • values of existing properties and the real property tax revenues from new construction increase at 2% annually. Annual projections of new multifamily development and senior apartment development are based on the prior 10-year average. Multifamily development from 2015-2024 resulted in 58 market rate projects occupying 244 acres, providing 16,558 units, that will generate approximately $55 million in property tax revenues in FY26 at a weighted rate of $1.0255 per $100 in value. In addition, there were another 11 senior apartment projects occupying 51 acres, providing 1,347 units, and generating approximately $2.9 million in property tax revenues in FY26. This analysis assumes the future annual average rate of 30 acres of land consumed for development will continue and approximately $5.8 million in increased property tax revenue would be generated absent the bill, with the value of existing properties and future construction increasing at 2% annually. As discussed below, this revenue projection is based on many assumptions, any one of which could significantly affect the actual revenue impact.
Staff Impact	DHCA indicates that its Multifamily Housing Program staff are at capacity. Under previous expansions of PILOT, DHCA saw a significant increase in the number of applications annually. This analysis assumes a similar increase in applications would result from the bill. DHCA estimates that it will require an additional 1.0 FTE Senior Planning Specialist position to provide staff support for those applications. The position's full-year compensation will increase expenditures by $134,600 annually. Without appropriate staffing support to review, negotiate, and process the expected increase in applications, transactions to create and preserve affordable housing units may be delayed.
Actuarial Analysis	The bill is not expected to impact retiree pension or group insurance costs.
Information Technology Impact	The bill is not expected to impact the County Information Technology (IT) or Enterprise Resource Planning (ERP) systems.
Other Information	
Later actions that may impact revenue or expenditures if future spending is projected	The bill does not authorize future spending.
Ranges of revenue or expenditures that are uncertain or difficult to project	DHCA notes that this analysis is based on the expenditure impact of Bill 2-25. Additional potentially significant expenditures for additional staffing and associated operating expenses would be needed if Zoning Text Amendments 25-01 and 25-02 are also enacted.

The forecast of lost property tax revenue relies upon the following assumptions, detailed further in this section: recent development levels would continue unaffected by any recently approved and/or implemented Montgomery County policies; there is ample supply of properties eligible for the PILOT if redeveloped into rental residential; developers will be able to reduce the vacancy at properties they wish to redevelop to 50 percent; and the PILOT will be attractive to developers and that all future multifamily supply will make use of the PILOT.

This analysis assumes 10 years of rental and senior apartment multifamily properties built between 2015 and the end of 2024 proxy the future average level of multifamily development and related taxable assessed value in the County. It is not possible to accurately predict the level of development that will occur in any specific year or the future development of any specific property. Future forecasts of development levels depend upon the assumption that future development trends resemble recent observable and measurable development trends. While a forecast of development and resulting tax revenues has general accuracy across a six-year time frame, the estimate of those individual years is less accurate given considerable variance between this calculated average and the potential actuals.

Through evaluation of Montgomery County's land records, Finance assumes the supply of property potentially eligible for the PILOT if redeveloped into residential use (4,764 acres) far exceeds the demonstrated demand for multifamily development (300 acres over 10 years). Further, Finance estimates that properties potentially attractive for redevelopment (1,524 acres) also far exceeds the potential demand for multifamily development.

This analysis assumes properties with both (1) a low ratio of building value to land value (indicating the existing structure is worth relatively little compared to the potential use of the land); and (2) and buildings that are older than 25 years are potentially attractive candidates for conversion from commercial use to residential use. In addition, this analysis assumes the PILOT substantially reduces property operation costs and thus will be highly utilized by multifamily builders, that there is an ample supply of properties that satisfy the criteria for the PILOT, and that as a result of the bill, most future multifamily rental properties will receive the PILOT and generate no real property tax revenue for at least 25 years.

This analysis assumes the existing weighted property tax rate of $1.0255 per $100 in taxable assessed value. Should the County Executive's proposed tax rate increase to $1.0605 per $100 of assessed value be approved, the amount of revenue lost would commensurately increase, with a $6.0 million impact in FY26. This analysis assumes properties currently under construction or development that otherwise would have satisfied the requirements of the PILOT will be allowed to make use of the program, resulting in a reduction in tax revenue starting in FY26. If instead developers of prospective projects must resubmit their applications, the loss of tax revenue may not start until two years after adoption of the bill. Finance assumes it takes two years to take a project from conception through the development and construction process.

This analysis assumes that townhome development will not be significantly impacted by the bill. While townhome development is eligible for the PILOT outside of the red policy zone, Finance anticipates that there will be few such developments that utilize the PILOT due to the required 15% MPDUs that must be located on-site of the development, requiring the development is a rental property, and that there is a limited market for rental townhouse developments. Any level of townhome development that does occur and is eligible for the PILOT would increase the loss in

	future real property tax revenue estimated in this analysis. The actual revenue impact may vary if development occurs at a different level or pace than assumed; if more or less development occurs at assessed values that are more or less than assumed; or if land prices for eligible properties increase due to utilization of the PILOT among multifamily developers, resulting in less multifamily development utilizing the PILOT than assumed due to the high cost of eligible land. In addition, the actual revenue impact may vary if this bill results in changes to other tax revenues such as income, transfer, or recordation as a result of new multifamily development. The actual revenue impact may vary if actual property attributes differ from those recorded in the Planning Department land database, therefore affecting the estimated value of properties and acres potentially eligible for the PILOT.
Sources of information	The analysis utilizes data from the Department of Planning (Planning) land use database, the State Department of Assessment and Taxation (SDAT), and the commercial real estate data company CoStar. Finance used geographic information system (GIS) software to evaluate Planning's land use database to identify office and retail properties (Commercial Properties) that are greater than two stories and could possibly satisfy the criteria for PILOT. Finance also used GIS to identify adjacent Commercial Properties as many developments are the result of combining multiple existing parcels. Finance used CoStar data to identify rental and senior apartment multifamily properties built between 2015 and the end of 2024, using this ten year period of multifamily development as a proxy for the future average level of multifamily development and taxable assessed value. Finance used SDAT data to identify the existing assessed value of the land and improvements for all properties and to estimate future real property tax revenue from multifamily rental developments.
Contributors	Somer Cross, Housing Chief, DHCA Robert Love, Affordable Housing Manager, DHCA Lawrence Cager, Multifamily Housing Manager, DHCA Pofen Salem, Chief of Finance and Administration, DHCA Nancy Feldman, Division Chief of Fiscal Management, Finance Dennis Hetman, Manager, Finance Todd Fawley-King, Fiscal and Policy Analyst, Finance Anita Aryeetey, Senior Fiscal and Policy Analyst, OMB Grace Pedersen, Fiscal and Policy Analyst, OMB

Council Staff Comments and Questions on Bill 2-25E Fiscal Impact Statement (prepared April 1, 2025)

OMB Submitted a Fiscal Impact Statement (FIS) for Bill 2-25E, Taxation - Payments in Lieu of Taxes - Affordable Housing Amendments on March 20th. Council staff shared questions regarding the analysis with OMB on March 26th. These questions are included below in the appendix, and staff has not yet received a response. It is possible that some analysis could change pending those responses[1].

Broadly, Council staff's questions relate to the selection of assumptions that ultimately generate just one scenario. While the choice of assumptions and analysis may be sound upon further investigation, OMB does not clearly explain the choice of assumptions, and the choice to not make other assumptions, in their memo. For this reason, Council staff have requested to engage in further discussions with OMB regarding their analysis.

There are two assumptions, in particular, that Council Staff are hoping to understand further. First, the FIS suggests that the increase in Assessed Value (AV) of new multifamily development compared to the vacant office buildings they replaced will not generate enough growth in property tax revenue by Year 26 (i.e., the first year after the abatement period is over) to replace the lost revenue of projects receiving the PILOT in Year 26.

A very high-level analysis suggests a nearly ten-fold increase in property value for a vacant office building that redevelops into multifamily housing. While this analysis is not intended to counter OMB's analysis, it does imply further investigation is needed to better understand the finding that by Year 26 there will be a stabilized annual loss in property taxes totaling $230 million.

[1] This memo was updated on 4/2/2025 to reflect that Council Staff has had discussions with Finance Staff, who conducted the analysis in coordination with OMB. Finance Staff have confirmed Council Staff will not receive a written response and while the questions were discussed, given the complexity of analysis and because changes during Committee would have altered assumptions in the FIS, Finance and Council staff could not meaningfully resolve Council Staff's outstanding questions.

Table 1: High-Level Analysis to Demonstrate Potential Net Increase in AV of New Multifamily Development on Qualifying Office Properties

Property Taxes	
2025 Assessed Value	$17,000,000
Property Tax Rate	1.15%
Property Taxes Paid	$195,704
Estimated Land Value Post-Development	$207,000,000
Property Tax Rate	1.15%
Property Taxes Paid	$2,382,984
Mulitfmaily Deliveries, 2015-2024	58
Estimated Current Taxes Paid	$11,350,832
Estimated Future Taxes Post-Abatement	$138,213,072

Table 2: High-Level Analysis to Demonstrate Potential Net Increase in Income Taxes

Income Taxes	
Mulitfmaily Deliveries, 2015-2024	58
Total Units	16,558
Average Project Size (Units)	285
Assume New Project at Avg. Unit Size w/ 15% MPDU @ 60% AMI	
Total Units	285
Market Rate	242
MPDU	43
Monthly Rent	
Market Rate	$3,250
MPDU	$1,805
Income Required	
Market Rate (at 30% of Income)	$130,000
MPDU (at 25% of Income)	$72,200
Annual Income Taxes Paid per HH	
Market Rate	$3,980
MPDU	$1,848
Total Annual Income Taxes Paid	
Market Rate	$963,160
MPDU	$79,464
Total Annual Income Tax across 58 Projects	$60,472,192

Second, OMB does not attempt to account for new income tax generated by housing growth and the net new residents that move into new housing units in the County. Income Tax can be difficult to forecast, and it is understandable that OMB does not want to undertake an unreliable analysis. However, the FIS does not acknowledge that there could be a significant income tax impact, which is relevant as a policy consideration. While not a forecast, a high-level analysis from Council Staff suggests a single multifamily building could generate over $1 million in income taxes. Accounting for a margin of error as high as 50%, this would be equal to $30 million across the 58 projects OMB assumes will be built over the next ten years.

Finally, in addition to the Council Staff's questions and high-level analysis of net increases to AV and income taxes, Council Staff does not agree that multifamily development will continue at the same rate it has over the past ten years. OMB has stated it makes this assumption because forecasting development is unreliable, and often uses this assumption in analysis of development-related policy, including for impact taxes.

However, this does not imply OMB necessarily believes multifamily development can be feasibly built under today's market conditions, which is ultimately the policy question underpinning the need for the bill. Bill 2-25E attempts to fill a feasibility gap for multifamily development, which has been generated in part by worsening market conditions. Council staff's financial feasibility analysis of multifamily development today suggest the PILOT can indeed fill this gap. Whether it should fill this gap, or the extent of the gap it should fill, is also a policy question.

Council Staff are available to help answer questions and time-permitted, can conduct additional analysis as needed.

Appendix

A. Council Staff Questions for OMB

1. Why does this bill create the need for a new position if the analysis assumes "that future development trends resemble recent observable and measurable development trends".

2. How does the analysis conclude that the stabilized annual loss in property will equal $230 million? By what year does the annual loss stabilize at this level?

3. Does this analysis assume that the property taxes based on the net increase in assessed value after the abatement period compared to the assessed value prior to redevelopment are outweighed by the forgone property tax revenue of new projects entering into an abatement?
   a. Can you please show the findings from your modeling that show that foregone property tax revenue of new multifamily development will outweigh the property taxes paid by properties reassessed after their abatement period is over?

4. The FIS notes "the PILOT will be attractive to developers and that all future multifamily supply will make use of the PILOT". Why does the analysis assume forgone property taxes for projects that are already entitled on non-qualifying sites (i.e., not on sites with highly vacant commercial development)?
   a. If there was evidence of which approved site plans/entitled projects can move forward to a building permit because they have secured financing, would the FIS reduce the fiscal impact by a corresponding amount?

5. Can you breakdown the acreage of eligible properties by retail and office properties?

6. Even under the assumption that any office or retail property can (and would) be made eligible for the PILOT, it would take time and resources for developers to make non-qualifying properties, qualify. Based on what evidence and data does the FIS find that there would be fiscal impacts in FY26 through FY28?
    a. Do you a list of currently qualifying, highly vacant commercial properties?

Alternative Scenarios:

1. There is a lag between changes in market conditions and its effects on development trends. Market conditions have real, measurable impacts on development feasibility. How would this analysis change if it accounts for the feasibility of development under today's market conditions?
    a. While it may not be possible to predict changes in market conditions, explaining trends like cap rate expansion (and all the factors it itself reflects) would help outline a scenario where development slows down.

B. High Level Summary of 2-25E Feasibility Analysis

Background

The market value of a rental product is determined by its cap rate. The market value of a project is its Net Operating Income (NOI) divided by its cap rate. Cap Rates are a simple metric tracked through observations of real estate transactions. The average cap rate in a region is just the average NOI of projects that were sold, divided by their average sale price.

Typically, for a project to pencil, a project's yield-on-cost (YOC), which is NOI divided by Total Development Costs, must exceed the cap rate by 1-1.5 percentage points (i.e., 100 to 150 basis points).

The reason a YOC must exceed the cap rate by a minimum amount is because the cap rate determines what someone *might* pay for a project; it's an estimate. The YOC measures NOI in relation to actual costs. Therefore, if the YOC is higher than the cap rate, investors and lenders know that even if their investment is not recouped by the sale of the project, the NOI will recover the development costs at a reliable rate.

This is important to note because while profit margins are inherent within a pro forma, the metrics developers use to test project feasibility do not necessarily involve increasing their own returns, but generating an output the meets the minimum criteria for investment and lending: the cap rate plus 100 to 150 basis points.

Development Prototype

This analysis is based on the feasibility of a 300-unit wood-over-podium multifamily mid-rise in a suburban part of the County.

Development Assumptions	
MPDU Requirement	15%
MPDU AMI	70%
Total Units	300
Market Rate	255
MPDU	45
Gross Avg. Unit Size (sf)	977.5
Market Rate	1,000
MPDU	850
Total Building Size	293,250
Site Size (acres)	3.0

Cost and Revenue Assumptions		
All-in Cost per sf	$450	
Total Development Costs	$131,962,500	
All-in Cost per Door	$439,875	
Avg. Monthly Rent	per sf	per unit
Market Rate	$3.25	$3,250
MPDU	$2.12	$1,805
Cap Rate	5.50%	
Min. YOC	6.50%	
Vacancy Rate	5.0%	
OpEx	30%	
% Increase to NOI	20%	

Feasibility Analysis

1. Under today's market conditions, projects do not pencil. For example, assuming a 5.5% cap rate, a 300-unit multifamily project generates a YOC of 5.4%, which is not only below the minimum 6.5% YOC for the project top pencil, but less than the cap rate itself. Based on council staff's analysis, not only does the market value of the project not exceed the cost of development by a sufficient margin, but it is also actually below the cost to build it.

Feasibility Analysis	Market Rate	MPDU	Total
Gross Scheduled Rents	$9,945,000	$974,700	$10,919,700
Less Vacancy	($497,250)	($48,735)	($545,985)
Less Operating Expenses	($2,983,500)	($292,410)	($3,275,910)
Net Operating Income	$6,464,250	$633,555	$7,097,805
Total Development Costs	($114,750,000)	($17,212,500)	($131,962,500)
Market-Rate Project Value	$117,531,818	$11,519,181.82	$129,051,000
Min. Req'd Return	$122,208,750	$18,331,313	$140,540,063
Residual Land Value (RLV)	($4,676,932)	($6,812,131)	($11,489,063)
RLV per sf			($87.92)
YOC	5.6%	3.7%	5.4%

2. Cap Rates in a region are a useful, general indicator of market conditions in the region, reflecting factors that affect real estate values like rent growth, job and wage growth, financing conditions, construction costs, and development policies in a jurisdiction. As of

2025, research suggests the cap rate in Montgomery County is approximately 5.5%. Compared to three to four years ago when cap rates were closer to 4% to 4.5%, the expansion in cap rates for a 300-unit multifamily project represents a loss in market value of between $28 million and $48 million.

3. With a 25-year tax abatement, the same 300-unit multifamily project is marginally feasible, generating a YOC of 6.5%.

4. Developers with a bearish attitude towards the market may not feel comfortable with a project generating less than a 7% YOC. Therefore, the tax abatement improves a project's feasibility from losing money compared to development costs, to generating enough return to cover the minimum buffer between market value and development costs that is required for projects to pencil.

   In this particular example, the net increase in the project's market value is approximately $25 million. Ultimately, worsening market conditions have rendered most multifamily projects infeasible under standard assumptions. The PILOT enables the feasibility of multifamily development and ensures that this development occurs on sites with underutilized buildings in highly-amenitized parts of the County that already have infrastructure to support housing growth.

Feasibility Analysis w/ PILOT	**Market Rate**	**MPDU**	**Total**
PILOT-adjusted NOI	$7,757,100	$760,266	$8,517,366
Total Development Costs	($114,750,000)	($17,212,500)	($131,962,500)
Market-Rate Project Value	$141,038,182	$13,823,018	$154,861,200
Min. Req'd Return	$122,208,750	$18,331,313	$140,540,063
Residual Land Value (RLV)	$18,829,432	($4,508,294)	$14,321,138
RLV per sf			$109.59
ROC	6.8%	4.4%	6.5%

5. Changing the MPDU parameters of the PILOT changes the feasibility of development.

	MPDU AMI (a)			
	30%	50%	60%	70%
MPDU Req.	$774	$1,290	$1,584	$1,805
15%	-33	-16	-7	0
17.5%	-44	-25	-14	-6
20%	-55	-33	-20	-11
22.5%	-66	-41	-27	-16
25%	-77	-49	-33	-21

Notes:
* This table shows the change from the baseline (15% MPDUs at 70% AMI) YOC when MPDU requirements and thresholds change.
**Rent shown is affordable for two-person households at respective AMI, based on FY24 HUD Income Limits.
*** It is hard to imagine how projects pencil once the YOC falls below 6.3% (i.e., 20 basis points below the baseline 6.5% assumption for feasibility)
*** Numbers shown in terms of basis points.