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Evaluation

of

"Economic and Fiscal Impact Analysis for the *Watergate Hotel* and *Proposed Watergate Condominium Project*"

Prepared by: Basile Baumann Prost & Associates, Inc. Annapolis, MD 21401

For: Monument Residential, LLC

Dated: May 1, 2003

* * * *

Submitted to the DC Zoning Commission (ZC #0316) in connection with Monument Residential, LLC's Application for a PUD Modification to Convert the Watergate Hotel from Commercial to residential use.

March 1, 2004

ZONING COMMISSION
District of Columbia
Case 03-16
Exhibit 109
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District of Columbia
CASE NO.03-16
EXHIBIT NO.109

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March 1, 2004

Ms. Carol Mitten, Chair
DC Zoning Commission
441 Fourth Street, NW, Rm. 210
Washington, DC 20001

RE: Monument Residential, LLC's Application for a PUD Modification to Convert the Watergate Hotel from Commercial to residential use.
ZC #0316

Dear Madam Chair and Commission Members:

I'm enclosing my evaluation of Basile Baumann Prost's study "Economic and Fiscal Impact Analysis for the *Watergate Hotel* and *Proposed Watergate Condominium Project*", prepared for Monument Residential, LLC as part of the latter's application for a PUD Modification (case #0316).

For the record, I'd like to state two facts:

1. My wife and I are residents and shareholders in Watergate East, Inc. (WEI), where we've made our permanent residence.

2. I've testified before the DC Board of Zoning Adjustment and the DC Zoning Commission on several occasions in connection with The George Washington University Campus Plan, and have been certified by the DC Zoning Commission as an economics expert witness less than two years ago. [Z.C. Case No. 01-17MM/93 5F/-18P (PUD AGC-1957 E Street, NW)].

In my enclosed report I've tried to avoid technical economic jargon in order to make it easily comprehensible. I've prepared this analysis (pro bono) under the rigorous standards of an expert witness and will be available for cross examination at the pleasure of this Commission, except for one week between March 3rd to March 9th, during which a prior commitment requires me to be in Canada.

Sincerely yours,



Sol S. Shalit
Professor Emeritus of Economics

(A) Watergate Condominium Project
Summary of Estimated Economic Impact to District of Columbia
Annual Operations (2003 Dollars)

Economic Impacts (1/)			
	Direct	Indirect	Total
Jobs (FTE)	41	412 (2/)	453
Payroll	$1,333,921	$10,246,110	$11,580,031
Residents earnings	$37,935,555		$37,935,555
Consumer Expenditure	$31,710,102		$31,710,102

Source Notes
1/ Total estimated jobs and payroll do not differentiate as to where employees live
2/ Includes jobs created from residential expenditures
Sources: Basile Baumann Prost & Associates

RIMS II: BBP use the parameters of RIMS II, a sophisticated, powerful, and complex econometric model developed by economists for input-output regional analysis. Under very careful and strict assumptions, this model can provide coefficients (called multipliers) which allow us to estimate the eventual impact (output) of an initial increase in factor input, say labor. The multiplier effect is basically rooted in the notion that one's income is partially spent and becomes someone else's income, which in turn is spend, etc., etc. You don't have to be an econometrician to use RIMS II multipliers; anyone can just look them up and do a simple multiplication, but what these numbers mean can make a world of difference. In the Appendix you'll find one page from an example of a correct economic application of RIMS II and what it takes.

How could 41 new direct jobs create 453 new (indirect) jobs, you may wonder? I wondered too. The answer is hidden in footnotes 1 and 2 of the table above. The practical meaning of Footnote 1 is that although BBP focus was the economic impact on the District of Columbia, they nevertheless chose to use RIMS II multipliers pertaining to the DC Metropolitan Area, which is a vastly larger area and 7.5 times larger in population alone. This means much larger multipliers and a far greater economic impact; it biased their results by making the condo look more favorable than it is. Although I have not calculated the magnitude of their bias, I have reasons to believe it is significant because the final impact is quite sensitive to small changes in the initial parameters.

But this bias does not fully account for how 41 initial jobs mushroomed into 453 new jobs. For this we have to uncover what's behind Footnote 2. It turns out that (BBP, page 9) the initial 41 jobs generated only 10 additional jobs and result in a total impact of 51 jobs altogether, a far cry from 453. Where did the other 402 new jobs come from? Footnote 2 and BBP, page 9 tell us: "402 of these 412 indirect jobs are a result of residential expenditures in the district." What they really mean to say is: "402 of these 412 indirect jobs are a result of expenditures in the district made by the new condo owners." There are some serious problems with that:

Assuming the new condo owners were previously living in the District, and moved into their new Watergate condo from other parts of town, would mean just a change in address with no economic impact whatsoever on the District, just a shift of expenditures within the District. To claim any economic impact by residents at all, one must rely on the condo owners being newcomers from out of town. Indeed, BBP's supposition is that the new condo owners are new to the District, and therefore they add a new influx of expenditures on goods and services in the District, with all the ensuing multiplier effects. They provide no basis for this crucial and rather strong supposition.

In fact, there is no basis for this supposition since it flies in the face of economic analysis and empirical reality. In order to claim any newcomer expenditure, standard economic methodology would start with net population growth in the city at large and then apportion the share estimated to go to a given specific location. BBP have not done that. Had they tried, they would have realized that, unfortunately, Washington is one of U.S. cities that have continuously declined in population for the past fifty years, while Washington's metro area continued to grow at a very robust rate. [Source: *Economic Review*, Federal Reserve Bank of Kansas City, Third Quarter 2003, pp. 28-39, based on U.S. Census Bureau data].

The supposition that the new Watergate condo, in and of itself, can somehow generate forces which would exempt it from the overall trend is, to be charitable, farfetched. Yet, this is precisely what BBP's hopeful supposition is based on:

> "The luxury condominium however represents an expansion of supply in the District of Columbia at a particularly unique location which will predominately represent "net new" demand for luxury housing units." [BBP, page 12].

The notion that "supply will create its own demand", especially "net new demand", violates one of most fundamental tenets of

economic theory. If it were true, there would never be office vacancies or corporate bankruptcies.

In short, that the new condo can be seriously offered as a panacea for the District's problems by helping it reverse a sad, long stretch of decline is an exercise in wishful thinking, but it makes the project look good, like "economic development". The reality, however, is that most -- if not all -- the new condo (co-op) buyers are likely to come from the District with no economic impact, beyond the temporary initial construction jobs connected with conversion itself.

Therefore, the corrected BBP's table should be:

(B) Watergate Condominium Project
Summary of Estimated Economic Impact to District of Columbia
Annual Operations (2003 Dollars)

Economic Impacts (1/)			
	Direct	Indirect	Total
Jobs (FTE)	41	10	51
Payroll	$1,333,921	$248,692	$1,582,613

Source Notes
1/ Total estimated jobs and payroll do not differentiate as to where employees live

As you can see by comparing this table (B) with BBP's original (A), the true economic impact of the condo (co-op) is only 51 jobs (instead of 453), or a total impact of $1,582,613 (instead of $11,580,031) -- quite a difference.

C. Economic Impact of the Hotel:

The economic impact of the hotel is (BBP, page 7):

(C) Watergate Hotel
Summary of Estimated Economic Impact to District of Columbia
Annual Operations (2003 Dollars)

Economic Impacts			
	Direct	Indirect	Total
Jobs (FTE)	228	122	350
Payroll	$6,650,628	$4,155,195	$10,805,823
Consumer expenditures	$5,370,382		$5,370,382

Note that consumer expenditures here are genuine and legitimate, precisely because they come from hotel lodgers who are out of towners.

BBP make light of the 228 jobs lost in the conversion by assuming they would mostly be absorbed by other hotels in the District, with not much of an impact on the District. They provide no basis for this supposition. The facts, however, point in a different direction. In order for these 228 jobs to be retained in the District, as BBP claim, there has to be some overall growth in this segment of the labor market to be absorbed into. It can't happen in a stagnant labor market. Here are some no-growth, sobering facts about this labor market:

1992-2002 District of Columbia (Annual Averages)

District of Columbia Wage and Salary Employment
By Industry and Place of Work Annual Averages - - - (In Thousands)

	SECTOR / INDUSTRY	
Year	**Leisure & Hospitality**	**Accommodation**
1992	43.7	15.4
1993	44.0	15.4
1994	44.6	15.3
1995	46.2	16.1
1996	45.3	15.3
1997	43.2	14.9
1998	42.2	13.3
1999	44.1	13.7
2000	47.9	14.9
2001	47.7	14.7
2002	47.8	14.0

Data includes all full and part-time employees who worked or received pay for any part of pay period which includes the 12th of the month.

Proprietors, self-employed, unpaid family workers, and private household workers are excluded.

SOURCE: Prepared by the DC Department of Employment Services Office of Labor Market Research.

Conclusion:

By comparing the totals of table B and table C you see that converting the Watergate Hotel into a condo (co-op) will result in a negative economic impact to the District: a reduction of about 300 jobs and a reduction in payroll of about $9 million.

D. Fiscal Impact on the District:

Although BBP's fiscal impact analysis suffers from some of the same problems as their economic impact analysis, I felt no need to analyze it in great detail. I would like to draw the Commission's attention to the following zoning case:

RE: Z.C. Case No. 01-17MM/93 5F/
91-18P (PUD AGC-1957 E Street, NW)
Zoning Commission's Hearing April 19, 2002

During the Zoning Commission Meeting on Friday, April 19, 2002, Alan Bergstein, Esq., the Zoning Commission's Attorney (DC Office of the Corporation Counsel) advised the Zoning Commission on the relevance to its deliberations of an Applicant's tax revenue consequences to the District. In this particular case the issue was whether the resulting reduction in District tax revenue was a relevant consideration, and the answer was no. By implication, the same answer applies a fortiori to an increase in District tax revenue.

Based on what the Corporation Counsel termed "research of the law", the Legal Opinion to the Zoning Commission was:

> " -- tax-exempt status of an Applicant for zoning relief is not something which should be relevant to a zoning authority. And for that reason it's been upheld that the zoning body should not consider the tax-exempt status of the entities, particularly if it involves the requirement of amenities."

APPENDIX

Table F.—Estimation of the Impacts of Sports Facility Construction Based on Data on Changes in the Bill-of-Goods, Kansas City, MO-KS Economic Area

Industry	Regional purchases in producers' prices (thousands of dollars)	Final-demand multiplier			Impact		
		Output (dollars)	Earnings (dollars)	Employment[1] (jobs)	Output (thousands of dollars) (col. 1 x col. 2)	Earnings (thousands of dollars) (col. 1 x col. 3)	Employment (jobs) (col. 1 x col. 4)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Paints and allied products	4,619	1.7722	0.3907	14.8	8,186	1,805	68
Miscellaneous plastics products	5,406	1.9872	.4842	21.5	10,743	2,618	116
Ready-mixed concrete	8,370	2.1576	.5266	23.9	18,059	4,408	200
Nonferrous wiredrawing and insulating	2,832	1.8598	.4000	17.0	5,267	1,133	48
Fabricated structural metal	6,167	2.2295	.5818	23.1	13,749	3,588	142
Pipe, valves, and pipe fittings	2,981	2.0844	.6050	25.2	6,214	1,804	75
Wiring devices	3,355	2.0838	.5857	24.6	6,991	1,965	83
Transportation	477	2.2263	.7393	31.5	1,062	353	15
Wholesale trade	2,936	2.0538	.6704	28.0	6,030	1,968	82
Engineering, architectural, and surveying services	18,732	2.6124	1.0134	43.1	48,935	18,983	807
Earnings paid to households	34,345	1.4569	.4331	23.0	50,037	14,875	790
Subtotal	**90,220**				**175,273**	**53,500**	**2,426**
Plus: Initial change					111,545	34,345	1,601
***Equals*: Total**					**286,818**	**87,845**	**4,027**

1. The employment multiplier is measured on the basis of a $1 million change in output delivered to final demand.

with associated earnings of $15.0 million. The impacts of the operation are estimated on the basis of bill-of-goods purchases.[26]

The bill-of-goods purchases are converted into regional purchases, in producers' prices, which are then multiplied by the appropriate RIMS II multipliers to yield the impacts. In table G , column 1 shows the purchases in purchasers' prices, column 2 shows which of these purchases occur in the economic area, and column 3 shows the purchases in producers' prices.

For example, suppose that all manufactured products are purchased from wholesalers, and suppose that the manufacturers from which the wholesalers purchase ice cream and frozen desserts and bread, cake, and related products are located outside the economic area. Then, for ice cream and frozen desserts and for bread, cake, and related products, the regional purchases in producers' prices are calculated for wholesale trade but not for manufacturing and transportation (column 3). For the other manufactured products, the regional purchases in producers' prices reflect the separation of the purchases into production costs, transportation costs, and wholesale margins.

For advertising, electric services, water supply and sewerage systems, insurance carriers, management and consulting services, and miscellaneous equipment rental and leasing, the regional purchases in purchasers' prices can be viewed as regional purchases in producers' prices because no margin adjustments are necessary.

For the $15.0 million in earnings paid to workers in the sports facility, only those earnings that are spent in the economic area can be viewed as purchases in the economic area. The earnings spent by households are likely to be less than the earnings paid, because a substantial part of earnings goes to high-salaried professional athletes, who are likely to save a larger-than-average share

Table G.—Purchases Associated With Sports Facility Operation, Kansas City, MO-KS Economic Area

[Thousands of dollars]

Industry	Total purchases (purchasers' prices)	Regional purchases (purchasers' prices)	Regional purchases (producers' prices)
	(1)	(2)	(3)
Manufacturing	2,200	1,681	1,136
Ice cream and frozen desserts	265	80	0
Bread, cake, and related products	235	101	0
Malt beverages	650	450	291
Bottled and canned soft drinks	500	500	370
Other food	550	550	475
Transportation			23
Costs:			
Ice cream and frozen desserts			0
Bread, cake, and related products			0
Malt beverages			10
Bottled and canned soft drinks			2
Other food			11
Wholesale trade			388
Margins:			
Ice cream and frozen desserts			9
Bread, cake, and related products			38
Malt beverages			149
Bottled and canned soft drinks			128
Other food			64
Electric services (utilities)	980	900	900
Water supply and sewerage systems	280	280	280
Insurance carriers	320	320	320
Management and consulting services, testing and research labs	1,500	900	900
Miscellaneous equipment rental and leasing	1,300	801	801
Advertising	1,200	1,200	1,200
Earnings paid to households	15,000	8,250	8,250
Total	**22,780**	**14,332**	**14,198**

26. These impact estimates are likely to be more accurate than those based on data for the commercial sports industry because the composition of purchases by each sports facility differs substantially.