With a mission to strengthen and broaden the City of Rockville’s economic base, Rockville Economic Development, Inc. (REDI) is pleased to present this annual report on economic indicators to the Mayor and Council. The report intends to provide a glimpse into the local economy’s current state relative to comparable communities within the region, while also examining Rockville-specific data trends over the past decade to provide historical context.

With nearly 40% of the City’s property tax revenue generated by commercial property, regularly monitoring the economic health of its commercial sectors is vital to the community. By ensuring Rockville continues to be a location of choice for businesses, the City is able to capture significant revenue that allows it to offer the renowned services it is known for.

The recession of the late 2000s continues to provide a challenge to this model, as communities have battled upticks in vacancy and reduced rental rates among commercial properties. Specifically in Rockville’s office market, the vacancy rate increased by 8.1% while the annual asking rental rate declined by $4.30 per square foot since 2007. The result is lower income for landlords, which translates to lower assessments and tax revenue. A primary driver for Rockville’s negative trends was the Federal government’s decision to shrink its footprint, which left significant blocks of office space vacant. While modest growth in the private sector has counteracted the losses, it is an ongoing process to reverse the trends of the past decade.

In addition to this annual report, REDI will present quarterly updates with recent data on indicators and news from the local business community beginning this spring.
Regional Comparison Overview

In order to better understand the context of Rockville’s business climate and inform economic development discussions, this section will evaluate its competitiveness on a regional level in comparison with five communities, plus Montgomery County as a whole for some metrics.

Given the diverse qualities of communities in general, finding equivalent competitors is a challenging exercise. When selecting these five communities, factors considered were their population, distance from Washington, DC (as measured from the White House), size of commercial property inventory, and economic development ambitions.

While initially looking solely at incorporated cities, the decision to add Vienna’s three zip codes was made due to the similarities in distance, quality/inventory of its office market, and access to Metro. Other cities considered, but not included, for the comparison were Alexandria (larger population), Falls Church (smaller population), and Leesburg (dissimilar office inventory).
Before looking at the comparative data of these communities, a deeper dive into their respective commercial real estate inventories provides a glimpse into the relative importance of each commercial market type to the economic success of the community.

In terms of overall commercial real estate inventory, Rockville is the leader with nearly 21 million square feet of space. The figure is 2.5 million square feet more than its nearest competitor, Gaithersburg, and nearly quadruple the 5.5 million square feet in Bowie.

As the chart indicates, Rockville’s inventory is dominated by office space as it comprises 64% of the overall square footage. Standing out in a similar fashion is Vienna, which actually exceeds Rockville’s office-heavy balance at 74% of its inventory.

Trailing Gaithersburg by only 125,000 square feet of total inventory, Frederick is the most equitable of the communities with each market representing close to a third of space.

Manassas is home to less than 50% of Rockville’s inventory with 9.5 million square feet and is the only community led by flex/industrial space, as it comprises 43% of its inventory.

With the smallest inventory, Bowie is the only community to be comprised mostly of retail with 61% of the space falling into that market.

The comparison of each community’s real estate inventory is not meant to conclude that one mix is superior, as the factors that resulted in these outcomes are varied. However, specifically for Rockville the comparison provides rationale for REDI’s primary focus on the office market given the significant role it plays in generating revenue for the City.
Regional Property Tax Comparison

Businesses are greatly affected by property taxes, even if they are renters. Whether paid directly through a triple-net lease in a restaurant or indirectly through a full-service lease in an office building, the majority of the property tax burden is passed onto the business.

As the charts depict, Rockville’s property tax rates are in line, or even more favorable, with the other communities. On the downside, Maryland’s corporate income tax rate is 2.25% higher than Virginia’s (8.25% vs 6.0%) and Virginia communities typically offer lower personal income tax rates as well. Note that Frederick County eliminated personal property taxes in 2015, while Manassas and Vienna only have one set of taxes due to their incorporation statuses.
Regional Incentive Comparison

Incentives continue to be a popular tool to recruit new businesses and help existing businesses expand their operations, although they are facing increased scrutiny to show results. Rockville introduced its first statutory grant programs in mid-2016 with $25,000 of seed funding. With the exception of Vienna, each of the communities offers some form of direct business incentives.

In order to induce significant activity, three cities substantially fund flexible programs through their general fund or property sales. Gaithersburg is the leader in incentive funding with both a flexible fund and annual program, while Manassas offers the widest range of assistance types.

**Business Attraction & Retention Grants**

City of Bowie
- Flexible case-by-case policy, which in FY 2016 approved a redevelopment project for $700,000 in funding

City of Gaithersburg
- Flexible opportunity fund for major projects, which is replenished as needed to retain $2,000,000 balance
- Statutory programs for property/tenant expenses, which are replenished annually with up to $125,000

City of Manassas
- Flexible opportunity fund for major projects, which is replenished as needed to retain $1,000,000 balance

City of Rockville
- Statutory programs for tenant expenses, which received $25,000 in FY 2017

**Façade Improvement Grants**

City of Manassas
- Statutory program for façade and landscape improvements, which are replenished annually with $100,000

**Fee Waivers**

Not statutory in any of the communities

**Job Creation Tax Credits**

City of Frederick
- Investment and new job credits

**Property Tax Credits**

City of Frederick
- Historic and/or rehabilitation projects

City of Manassas
- Rehabilitation projects

City of Rockville
- Green building renovations
Despite ongoing turbulence in the sector, certain markets are stabilizing. Montgomery County is one example, as its vacancy rate decreased by 0.2% from 2015. Making similar progress were Manassas and Vienna, who saw dips of 2.4% and 0.4%, respectively, in the same period.

Rockville’s vacancy increase of 1.6% was attributed entirely to the relocation of the Substance Abuse and Mental Health Services Administration in late 2016. The federal agency vacated 228,000 square feet at 77 Upper Rock, which equates to 1.7% of the City’s office inventory. With this move and several other large federal vacancies in the rearview mirror, the vacancy rate should improve as positive growth from the private sector begins to backfill those spaces.
Regional Retail Market Comparison

The region’s retail market continues to perform well, as the majority of surveyed communities saw a decline in their vacancy rate. Similarly, the majority currently have a vacancy rate comparable to the figure from before the recession began in the late 2000s.

Despite the dwindling amount of available space, growth in the rental rates was mixed as several markets experienced slight drops. Note the figures for Bowie and Vienna are greatly influenced by large vacancies that distorted the asking rental rates in each community in 2015 and are therefore not accurate portrayals of their trendlines.
Montgomery County and its communities exhibited the best year in the flex/industrial market, as they all exhibited growth in asking rental rates and mostly showed decreasing vacancy. Rockville experienced an uptick in vacancy, but the figure is not far from its historical average.

Within the region the market faces pressure from mixed-use redevelopment in the core and inner suburbs, which is leading to a decreased supply for the wide-range of businesses that occupy this property type. Given the affordable rents, the spaces are also drawing attention from unconventional businesses like breweries and artisanal food producers.
City of Rockville Overview

With nearly 21 million square feet of commercial property, Rockville is home to more than 75,000 employees in a diverse array of industries. Nearly two-thirds of the property is used as office space, while the remainder is split evenly between flex/industrial and retail uses.

The sizable gap in the property types places a higher importance on maintaining a healthy office market. While Rockville regularly posts the lowest unemployment rate for residents (2.8% in November 2016) among Maryland’s municipalities, the preceding and forthcoming slides show there are challenges in maintaining demand for the City’s office supply.

![Rockville's Unemployment Rate since 2014](image)

Source: Maryland Department of Labor, Licensing, and Regulation

![Share of Commercial Real Estate Inventory by Square Footage](image)

Source: CoStar
Commercial and residential property taxes accounted for over 50% of the City’s general fund revenue sources in the FY 2017 budget, which indicates the importance of sustaining property values throughout Rockville. Property taxes include real property for both commercial and residential uses, while only commercial uses are assessed personal property tax.

Commercial property taxes contributed between 37% and 40% of the overall property tax revenue since 2008, with personal property accounting for roughly 8% of that figure annually. Note that information is unavailable for FY 2014 and 2015 due to issues with the State’s data.
With a vacancy rate exceeding 20.0%, Rockville’s office market lags behind its regional counterparts. The trend of rising vacancy continued in 2016, although the figure is entirely attributable to the previously mentioned 228,000 square foot relocation of a federal agency. Given the positive private sector activity of 2016, the trend is likely to turn around in 2017.

In terms of quality, CoStar rates 35% of Rockville’s inventory as 4 or 5 stars (similar, but more exclusive than Class A). While this product is increasingly attractive in a competitive workforce market, the subpar location of these buildings resulted in growing vacancy and shrinking rental rates approaching those of lower quality product, which is advantageous for tenants.
A more in-depth analysis of Rockville’s market shows specific concerns for the King Farm/Piccard and Tower Oaks submarkets, as the vacancy rates are nearing 30.0%, while Town Center is the standout with a rate just above 8% and rents exceeding $30.00 per square foot.

While not solely attributable to these factors, the lack of amenities and transit access provide a point of differentiation between those submarkets and factor into their respective states. While having access to Twinbrook Metro, the South Pike area suffers from a different problem: a complete lack of quality office product within the City limits as the next page will show.
Regionally, there has been a flight to quality office buildings as businesses are taking advantage of lower rental rates to provide superior access and amenities needed to attract talent in a tight workforce market. By exchanging larger spaces for more dense layouts, tenants are able to lease higher quality space for similar prices as lesser product.

While Rockville has a sizeable supply of 4-5 star product, the majority is isolated in more traditional office parks devoid of amenities and removed from transit options, thus reducing its desirability. The lower chart shows the widening contrast between space near Metro and an I-270 interchange, as they generally trended together but have now broken apart since 2013.
After weathering the fallout from the recession, Rockville’s retail market has found stable ground and experienced a strong 2016 with decreased vacancy and increased rents. With another strong year in 2017, both figures will potentially reach their pre-recession values.

While Town Center’s retail scene has seen its struggles, the recent addition of several exciting tenants combined with ongoing development is sure to lead to a more vibrant environment. In the period from 2015 to 2017, the area will be supplemented by 733 housing units, 140 hotel rooms, and nearly 30,000 square feet of retail, which adds a significant consumer base.

Source: CoStar
While posting its highest vacancy rate in the past ten years, the flex/industrial market has seen this figure fluctuate regularly over the timeframe within a margin of roughly 2.0%. Conversely, the rental rates have reached their highest point which indicates demand exists.

The market is well-positioned for the future as industrially-zoned property continues to dwindle in the urban areas of the region, particularly near the District, and Rockville’s proximity to population centers make it an ideal location. Maintaining a supply of this product is vital to supporting service providers and creative uses that repurpose the more affordable space.

Source: CoStar
City of Rockville Selected Transactions in 2016

A strong year of private sector activity resulted in significant absorption across all commercial markets and helped counterbalance large vacancies left by the public sector in the office market. The expansions and relocations listed below are a sample of this activity and represent more than 200,000 square feet of deals that added over 375 jobs to the local economy.

- **ALQIMI**
  - Cybersecurity
  - 8,640 SF relocation

- **Cornerstone**
  - Engineering
  - 11,583 SF relocation
  - 35 employees

- **CRB**
  - Nonprofit
  - 31,857 SF relocation
  - 78 employees

- **CREDIBLE**
  - Computer Software
  - 38,345 SF relocation
  - 86 employees

- **Emmes**
  - Research
  - 12,846 SF expansion

- **Inteleos**
  - Nonprofit
  - 15,398 SF expansion
  - 12 new employees

- **Integrated Biotherapeutics**
  - Biotechnology
  - 10,698 SF relocation
  - 28 employees

- **Lafayette Federal Credit Union**
  - Finance
  - 30,000 SF relocation
  - 60 employees

- **Quiet Sweep**
  - Service Contractor
  - 10,000 SF expansion
  - 25 new employees

- **Prometic Biotherapeutics Inc.**
  - Biotechnology
  - 16,000 SF expansion
  - 26 new employees

- **Scheer Partners**
  - Real Estate
  - 6,625 SF relocation
  - 25 employees

- **Zenimax Media Inc.**
  - Computer Games
  - 8,764 SF expansion

Source: Rockville Economic Development, Inc.