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FREDERICK'S CITY 'HOTEL CONTAGION' SPREADS

County wants "incentivized" hotels in Brunswick, Middletown, Myersville, New Market, Thurmont…

BY PETER SAMUEL

IN AN EFFORT TO OPEN COUNTY COFFERS TO HELP FUND THE HAPLESS Frederick City–sponsored Downtown Hotel & Conference Center project, Frederick County has embraced a "hotel development incentive program." The program—adopted as part of a bill that raises the County's hotel room tax from 3 percent to 5 percent—would deliver a large tax break to approved new full-service hotels/conference centers, slashing the hotel room tax to as little as 0.75 percent, ostensibly to help the new facilities service their debt. Of course, existing county hotels would get nothing except tax break–subsidized competition.

The immediate beneficiary of the scheme is likely to be the proposed Downtown Hotel & Conference Center. Offering the same breaks to other facilities built in the county's other municipalities is a way to rally support outside the city for the unpopular project. At the county council meeting that endorsed the scheme by a 4–3 vote, officials from a number of the smaller towns spoke in favor of it.

Amazingly, there was little discussion of the public revenue cost of the proposal. The staff report on it claims that it would have no "financial Implication." That is obviously misleading.[1] The tax breaks under the program would have a hefty price tag even if only one hotel takes advantage of it. Consider a 200-room hotel earning $10 million in room revenue a year. Its tax break would be as much as $425,000 a year for 25 years, for a total of $10.6 million over the life of the program.

By one official account,[2] the incentive program would only be available to cover debt payment on the "public portion" of such a hotel project. In the case of the Downtown Hotel & Conference Center, a wide range of expenses are deemed to be public, including parking garages, conference/meeting rooms, the land on which the hotel is built (which the facility would lease for 99 years for a nominal annual rent), utility enhancement costs, and "pre-development costs" including design, legal fees, consultants, permitting expenses, and the like. When it comes down to it, the "public portion" of such projects is whatever government officials say it is.

The same can be said about the justification of the program: it is whatever public officials say it is. Writes the county director of economic development, "These incentives have been found to be necessary to attract the level of hotel and conference center development that communities need."

Need?

That judgment of need here was made by city government, which appointed a downtown hotel advisory committee comprised of the local chamber of commerce and Downtown (business) Partnership supported by city staff from its department of economic development. Public money is needed for the facility because, they claim, the city must attract high-level professionals to work in local businesses and because the county must host prestigious conferences. And tourism people are sure the facility is the key to attracting lots more big-spending visitors to the city, while developers and planners want it for its supposed "catalytic" and "jump-starting" effects on development of languid portions of the downtown.

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The people who do *not* find a need, however, are the real customers: people who will book rooms and stage conferences. By no one's estimates will real customers generate the revenues to support the $84 million hotel complex, which was in effect designed by the city's advisory team from the local business community. They specified in the city procurement of a developer all the extra features and the high quality they thought it would be nice to have. Nice to have … if someone else pays! The developer estimates that the complex will only support investor outlays of $53 million. So it is simple arithmetic that the envisioned facility will need upfront public subsidies of $31 million.

Heywood Sanders, a professor of public administration at the University of Texas, San Antonio who specializes in hotels and convention centers, says upscale, full-service conference center hotels almost never make financial sense in the downtown of small cities like Frederick. The extra costs involved, both in capital expenditure and operations, just aren't justified by any extra revenue they generate. The many activities involved in a full-service hotel are also very difficult to manage, he says. However, the bigger problem for Frederick is that the hotel's anticipated top customer, the federal government, limits "per diem" lodging rates to about $100 and mandates that they will only be paid if the lodging is at least 50 miles from employees' workplaces. The proposed upscale hotel is aiming at $160 per night rooms, and Frederick is a scant 43 miles from the White House.

The city hotel & conference center project thus faces a whole laundry list of problems, and needs a whole lot of taxpayer money to come to fruition. Hence the county council's desire to throw some money the city's way. But to do that, the county must also throw money at other municipalities, which will create more problems. Among them:

- **Distorting the Market:** The prospect of major tax subsidies favors one hotel over others and draws resources to less efficient operations at the expense of more efficient self-financing hotels. By adding uncertainty about the advantage that a competitor may have, this scheme adds to the financial risk for self-financing businesses and so will discourage regular investment.

- **Raises Tax Rates:** Over time, doing special tax favors for a few favored entities will result in an increased tax burden on others. Hotel taxes are the source of funding for tourism promotion. Each hotel that gets the favored tax break for 25 years is a hotel that is not paying its fair share for tourism promotion, which means a heavier burden on other taxpayers.

- **Rewards Political Skill, Not Business Acumen:** Eligibility for the big 25-year tax concession could be so valuable that businesses will put a premium on politicking over business management. There will be political competition to get the incentive program for one's own business while working to deny it to competitors.

- **Outsourcing Administration to the Tourism Council:** An especially troublesome feature of the Frederick bill is that it puts control over the administration of the tax incentives in the hands of the county tourism council, a trade group comprising some 300 members engaged in visitor businesses, granting them in effect the power to operate as a cartel.

- **Legality:** State law authorizing the county to collect a hotel tax (Maryland Code, Local Government, § 20-406 through § 20-419) does not seem to give the county discretion to rebate any tax or to set aside a tax normally going to tourism purposes. In effect, the proposal would establish differential rates of taxation. It is highly doubtful the General Assembly intended for local officials to have that ability—let alone delegate that power to a trade group whose members could keep up to 85 percent of taxes normally due.

In the real world, this theory sometimes works, and sometimes doesn't. And when it doesn't, it places new hardships on already-struggling communities.

- **They Don't Fit:** A "full-service conference center hotel" as specified by Frederick County is a large, integrated hotel complex that doesn't fit in the narrow-street, small-lot, mainly two-story downtowns of the county's many municipalities. Small scale is part of the charm of historic centers—another charm is the paucity of persnickety regulation, which allowed them to evolve with a spontaneity rarely possible today. That charm is lost when large-scale "flagship" hotel complexes are introduced through city sponsorship.

- **Full-Service Superfluity:** The full-service hotels targeted by this proposal would offer services such as bars, restaurants, spas, gyms, pools, and meeting rooms. Offering those services within the one hotel complex makes sense for isolated resort-style hotels—e.g., the Greenbrier in White Sulphur Springs, W. Va. or the Omni Bedford Springs in Bedford, Pa. But such facilities make little public sense in a county with a range of existing eating, drinking and other service establishments nearby. The cost and management of full service add risk to such projects and minimizes spinoff benefits to nearby businesses.

The economist and political philosopher Friedrich Hayek famously wrote about the "fatal conceit" of government officials who think they know better than the interaction of consumers and businesses that is the market. At no point in the many years that Frederick County and City officials and appointees have advocated the Downtown Hotel & Conference Center have they demonstrated that they better understand the area's lodging needs than investors who have incentive to provide what customers will pay for. The standby justification is that expert consultants have "validated" the city's vision for the hotel as "viable" but only with "substantial public support." That is just another way of saying it is not, in fact, financially viable and must be made so artificially with public money.

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1. County staff claim that since hotel tax revenues (minus an administrative expense) are all passed on to the county's tourism council, they are not part of the county budget. That overlooks the reality that (1) as hotel taxes revenues are attritted by the rebates for favored capital projects, their traditional purpose—tourism marketing—will suffer to the likely detriment of a city seeking visitors, and (2) any shortfall in hotel tax dedicated to council-underwritten loans could mean the county has to use general funds to cover the shortfall.

2. The formal Memorandum of Understanding amendment between the county executive and the tourism council limits the debt supported to "debt on capital expenditures related to constructing public improvements required for a full service hotel and conference center … to include parking, road work and meeting facilities." In the planned downtown hotel complex in Frederick the parking and meeting facilities would be operated as part of the hotel business under the control of the hotel, with the hotel entitled to all the parking and meeting space revenues. The county executive's staff report to the County Council dated June 27, 2016 refers to the tax incentives as available to support any hotel debt. The texts of both are available in this pdf: https://frederickcountymd.gov/DocumentCenter/View/291110