A Benefit-Cost Analysis of the San Marcos Conference Center in San Marcos, Texas.

By
William Brandon Tanous

Political Science 5397
Dr. Kay Hofer

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Introduction

Benefit-cost analysis is a tool that decision makers in both the private and public sectors utilize to make accurate and credible spending decisions. Without such a tool, individuals often make decisions without proper consideration of a project’s potential risks or benefits. A sound benefit-cost analysis helps decision makers assure that a project will be a viable use of public funding (Mikesell 2007, 263). Conducting such an analysis also allows administrators to have a sense of confidence and assurance of cost efficiency.

The City of San Marcos committed $20 million dollars over the next 25 years to develop a state of the art conference center without the aid of benefit-cost analysis. Cities often make such capital project decisions without formal analysis. Though the City of San Marcos did not perform an official benefit-cost analysis of the project, the city council did look at similar conference center projects that were completed by Hammons in other cities of similar size and economic standing. Along with researching other projects developed by John Q. Hammons, San Marcos reviewed the feasibility study and economic viability estimates of a similar project made by city officials of New Braunfels, Texas. Because of the project’s size and the length of financial commitment required, the conference center decision carries potential financial risks if the expected revenue sources do cover the costs of the project. If the project is underutilized or experiences major cost overruns, future capital development might have to be deferred.

A benefit-cost analysis is beneficial when projects are costly or when they increase financial risks to a community. When public funding becomes scarce, a benefit-cost analysis takes on more importance and helps assure the project will provide the best return on
investment. Many public sector entities are relying more heavily on benefit-cost analysis to help make decisions that will benefit their community or constituents by effectively using public resources (Fuguitt and Wilcox 1999, 3). However, while conducting a benefit-cost analysis can be a useful tool when making public decisions, problems in the system can exist.

**Research Purpose**

This research will accomplish three things. First, it will present a detailed discussion of benefit-cost analysis and how public officials use this information to impact and improve capital budgeting decisions. Second, it will apply the theory of benefit-cost analysis to a real project: the Conference Center in San Marcos, Texas. Finally, this research will explore the motivation behind building the Conference Center and will determine whether city officials used internal analysis to assess need, or if that need was based on perceived indirect benefits and/or other political factors.

This research will consider the many uses of a benefit-cost analysis primarily at the public sector level. A benefit-cost analysis reviews potential long-term projects often in government entities’ capital improvement plans for future development. When such analysis is properly designed and employed by a government entity, decision makers will normally be able to choose the development that best suits their needs (Markovits 1984, 1171).

Public officials use benefit-cost analysis as a technique for evaluating the social profitability\(^1\) of alternative uses of local government’s scarce resources (Galambos & Schreiber 1978, 62). The scarcity of public funds and limited resources encourages decision makers to use tools to make sound financial decisions. A proper benefit-cost analysis considers the monetary and non-monetary benefits and costs of potential projects. Non-monetary benefits and costs

\(^1\) Generating the most benefits for the community relative to the costs incurred.
included in a benefit-cost analysis are variables important to the morale, growth, and economic standing of the community (Fuguitt and Wilcox 1999, 173). An example of non-monetary costs might include the potential negative environmental impact from a project on the surrounding community, while an example of non-monetary benefits might include a sense of community unity or accomplishment.

Government entities regularly evaluate capital improvement projects to determine their potential benefits and risks to the community. With the use of a benefit-cost analysis, government entities can make more informed decisions, using accurate and credible data that forecast the benefits of capital improvement projects rather than coping with the negative effects of an ineffective project after its completion (Markovits 1984, 1171). Even though a project is already underway, government entities may still use the information from a benefit cost analysis to anticipate problems and make adjustments where necessary.

The planned development of the New Braunfels Convention Center is a similar project in close proximity, less than thirty minutes, from the City of San Marcos. An indirect factor such as this duplication of effort could present a financial risk to the San Marcos Conference Center, as both will compete to host similar events (Millar 1988, 67). Indirect factors should be considered when analyzing the results of a benefit-cost analysis.

Purpose of Conducting a Benefit-Cost Analysis

Because of the level of public funds committed long-term, major capital improvement projects such as conference centers, often are evaluated using benefit-cost analysis. By using such analysis, government entities can make more informed decisions. Projections of a development often are available before it is completed, which aids decision makers to deal with the negative effects of a project before problems arise (Markovits 1984, 1171).
The developer, John Q. Hammons, approached the San Marcos City Council in October of 2003 regarding the development of a hotel and conference center. The Council discussed the conference center and researched other Hammons’ projects and properties that were similar to the proposal for San Marcos. The Council encouraged input by holding public stakeholder meetings and providing an open forum at city council meetings. The original site of the project was to be on a fifteen-acre tract overlooking Spring Lake that drew wide-spread opposition by residents due to its environmental impact. Despite these concerns, the city council signed a Memorandum of Understanding (MOU) at the December, 2004, city council meeting demonstrating an interest in a public-private partnership to develop a hotel and conference center. In March, 2006, the City Council of San Marcos voted and approved the Master Development Agreement detailing the project’s scope and the entities’ responsibilities.

The City Council of San Marcos created a Tax Increment Reinvestment Zone (TIRZ), which pledged property tax revenue and other revenue from the project to repay the debt for construction of the conference center. The city also sold twenty-three million dollars in combination tax and revenue certificates of obligation to fund the conference center project. The cost estimates for the Conference Center project were created by the developer and negotiated between Hammons and the City of San Marcos to come to agreement on the price. Revisions in engineering and designs were conducted to reach a cost target that the City set and negotiated with Hammons on the appropriate cost share amounts.

Upon completion in October, 2008, this project will provide the area with a ten story, upscale, full-service hotel with two hundred eighty-three rooms and a 77,300 gross-square-foot conference center that will hold up to one thousand people (City of San Marcos 2007, 1). The conference center is expected to attract a wide range of conferences such as auto and boat shows, high-tech exhibitions, graduations, special events, and business meetings of all sizes (City of San
Marcos 2007, 1). Conferences are expected to take place mainly outside of the peak summer period and are estimated to attract mostly association, business, and university events that require break-out rooms\(^2\). Approximately four to eight break-out rooms with a capacity of 250-500 people are traditionally needed for the type of meetings and conferences expected by the City (City of San Marcos- TIRZ 2006, 13). This development will be the first of its kind in the City of San Marcos. The conference center project is expected to attract conferences, tourism, and developments near the project site and boost the city’s economy by providing additional revenue and property value.

The research will analyze the results found and determine if the outcome supports the city’s decision. The research also will review the results of the analysis to determine if social or political factors appeared to outweigh the benefits and costs of the City of San Marcos’ decision. The overall results of the research will be used to determine if the conference center project is a viable use of public funds. The research also will provide a basis for public decision makers to review and determine if benefit-cost analysis is useful when choosing among future capital improvement projects that will use public resources.

**Conceptual Framework**

The conceptual framework for this applied research project outlines the variables involved in conducting a benefit-cost analysis and links those variables to existing literature. These variables include the direct and indirect costs of the project, the perceived direct and indirect benefits from the project, and the discount rate. Though a benefit-cost analysis can measure social benefits, this research will confine itself to economic aspects along with a few indirect (estimated) and/or external benefits and costs. The variables essential for a sound

\(^2\) Rooms that can be made by sub-dividing large open ballrooms and halls into smaller more manageable rooms.
analysis of the San Marcos Conference Center project were identified through scholarly research.

Table 1 contains the conceptual framework that will guide this research project.

Table 1: Conceptual Framework Table

<table>
<thead>
<tr>
<th>CONCEPTUAL FRAMEWORK</th>
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<tr>
<td>Research Purpose: To perform a Benefit-cost Analysis of the San Marcos Conference Center in San Marcos, TX.</td>
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<tr>
<th>BENEFITS:</th>
<th>SCHOLARLY SUPPORT:</th>
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<td>Direct Benefits:</td>
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<td>(RT) Revenue from hotel occupancy taxes</td>
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<td>(PT) Property Tax Revenue from Hammons Hotel</td>
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<tr>
<th>DISCOUNT RATE:</th>
<th>SCHOLARLY SUPPORT:</th>
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<td>Private: 7%</td>
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The identified benefits and costs pertinent to conference centers have been defined by scholarly works and reflected in the literature review. The literature review identified the main variables and categories needed to conduct a benefit-cost analysis. The cited scholars named in the conceptual framework have explored the importance of these factors in determining the viability of a conference center project. Except for the variables of traffic congestion,
environmental impact, competition from other conference centers, indirect development, and property tax revenue from indirect development, the benefits and costs of the project are tangible items that can be converted to monetary value. In order for a conference center project to be deemed viable, the analysis should indicate that the benefits outweigh the costs throughout the center’s useful life (Galambos and Schreiber 1978, 73).

The discount rate can have a substantial effect on the overall viability of the project. Varying discount rates will be used in order to assess the present value of future costs and benefits (McKenna 1980, 135). For example, the higher the discount rate, the lower the value of future benefits. The combined factors of discount rate, benefits, and costs will determine the economic feasibility of a capital improvement project. Many small cities are considering investing in the construction of conference centers to increase the cities’ economies or boost tourism and visitors to the communities (Talbert 1998, 6). Cities such as San Marcos and New Braunfels expect to capitalize on such economic benefits by investing in conference centers as larger cities have already done.

Direct Benefits

The benefits of a project include the increases or gains in goods or services generated by that project. Direct benefits are those directly associated with the development of the project. For example, direct benefits from hosting events at a conference center might include revenue from the rental of the conference room to the sale of concessions (Safavi 1971, 21). The types of direct benefits that are typically associated with hotel and conference center projects include the creation of jobs, increases in hotel occupancy taxes from conference attendees staying in local hotels, sales tax revenue from food, entertainment, and goods and property tax revenue from the attached private hotel (Safavi 1971, 21). The City of San Marcos also will directly benefit from
revenue derived from the leasing of the conference center to Hammons. Though the lease amount will go toward retiring the debt for the first twenty-five years, once the debt is retired, the consumer price index will dictate the future costs of the lease to Hammons or any other private entity. Direct benefits are represented on the ledger of the accounting records and are essential in justifying the development of a project.

*Indirect Benefits*

Indirect benefits include those not directly associated with the project that arise as a direct result and are occasionally the primary reason why projects are selected. Indirect benefits allow government entities to develop capital improvement projects that will affect positively the surrounding area. Indirect benefits from conference centers include the creation of employment opportunities outside of the hotel and conference center project, new development, property tax revenue and sales tax revenue from indirect development, and the expansion of existing businesses near the conference center (Talbert 1998, 14).

The San Marcos Conference Center and other similar conference centers tend to benefit more from indirect revenues than from direct revenues. Conference centers generally do not produce a meaningful flow of revenue, so revenue that government entities gain from money spent by conference delegates before, after, and between conference meetings is vital and a compelling motivation to build such centers (Talbert 1998, 13). Indirect benefits should be considered and estimated when performing a benefit-cost analysis, but are not part of the project’s official financial records.

*Direct Costs*

Direct costs are the direct capital costs of building the project (Safavi 1971, 21). These direct expenses include construction and operating and maintenance costs over the life of the
project, accounted for on an annual basis (Mikesell 2007, 269). Other direct costs include supplies, labor, and the purchase of the land. The operating and maintenance costs of the facility will not be considered in this analysis due to Hammons’ obligation to pay for these costs throughout the lease terms. The City may have to fund maintenance on some equipment and appliances. However, because these items are likely to carry initial warranties, these costs will be excluded from the analysis. Other initial costs defined by McKenna (1980, 134) include research and development, planning, testing and evaluation\(^3\), and vehicles and equipment. These initial costs are included by the builder in the total cost of the project.

Recurring (ongoing) costs also associated with conference centers include salaries and benefits of personnel, materials, rental of buildings and equipment, facility maintenance, service expenses, administrative overhead, public relations, education, security, and insurance (McKenna 1980, 135). Initial and recurring costs can be substantial for government entities. The recurring costs of the San Marcos Conference Center will be paid by Hammons through the life of the lease and, consequently, will not be considered in the analysis (City of San Marcos-Development Agreement 2006, 18-19).

**Indirect Costs**

The indirect (external) costs of a project include the costs of goods and services that government entities must consider in developing and sustaining such a project. Indirect costs affect a government entity by requiring additional facilities or services for the conventioneers (Safavi 1971, 21). Indirect (external) costs that many municipalities face because of conferences include added pollution, traffic congestion, and an increased need for emergency services (Gupta 1994, 336). Other indirect costs from the development of a conference center include

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\(^3\) After the construction of a structure is complete, a testing and evaluation of the integrity of the structure must be done as part of the permitting and certification process. Buildings must be tested and evaluated to receive a certification of occupancy and deemed safe by building code standards.
competition from conference centers in cities of close proximity and the threat of a potential negative environmental impact. Traffic congestion and added pollution have caused many cities to evaluate proposed locations for conference centers and make recommendations that would not severely impact the city’s mobility and environmental issues (Sanders 1971, 153).

Since this project is located in an unpopulated area of the city next to the interstate and with direct access to north and southbound lanes, traffic congestion is not expected to be a major concern. An increase in emergency services, such as police to direct traffic, is not expected to be an issue since the conferences will be small in size (around 250-500 people). Should additional law enforcement services be warranted, Hammons would assume this responsibility. Since private entities are responsible for funding police services that extend beyond the normal duties of the police department, the need for police services will not be part of this analysis.

This analysis will consider the project’s potential environmental impact on the City and on the area. So far, the environmental impact on the current location of the conference center has been minimal. A copy of the environmental impact statement (EIS) is available at the City Manager’s Office and from the Texas Commission on Environmental Quality. The state requires an EIS on all physical improvements to the land and that it be a matter of public record. Dan O’Leary, the City Manager of San Marcos and direct contact for the conference center project, stated that there were no significant environmental concerns from the development of the hotel and conference center. This outcome is a positive result of moving the location from above the head waters of the San Marcos River, which brought up many concerns of a significant environmental impact from environmental agencies, environmental groups, and the general public, to its current location. The existing location of the project’s site has eliminated any opposition about environmental concerns.
Competition from conference centers in San Antonio, Austin, and the proposed New Braunfels project, could have a potentially negative effect on the viability of the San Marcos Conference Center. Though the San Marcos project is ideal for smaller groups and associations that do not need large spaces, the other cities also are competing for similar patrons. The proposed New Braunfels project is the closest to San Marcos and is the most apparent risk to the City’s project. The City expressed that the lack of sufficient parking and hotels adjacent to the proposed New Braunfels site is expected to deter some conference planners. However, the City Manager’s Office does view the proposed New Braunfels project as a potential risk to the economic viability of the San Marcos Conference Center. The indirect costs mentioned are nearly impossible to measure but should be considered when evaluating the location, size, and accessibility of the project.

**Discount Rate and Time**

The benefit-cost analysis must incorporate the discount rate and time for a project to determine the future benefits and costs of the project. Since most public projects create a flow of cost returns over several years, both benefits and costs should be converted or discounted to present value for comparison (Mikesell 2007, 272). Future benefits of a project are generally assessed at a lesser rate than present benefits, which reduces their value and emphasizes the selection of an appropriate discount rate. There is no universally accepted procedure for determining the appropriate discount rate when evaluating public projects beyond the break-even analysis (McKenna 1980, 135). Public and Private entities generally use varying discount rates in accordance with the project being financed and the amount of time that benefits and costs are projected to occur.
An analysis is more objective when a variety of discount rates is used. Scholars Jean-Francois Mertens and Anna Rubinchik-Pessach explained the importance of using discount rates in their paper presented at the spring, 2006, Microeconomics Theory Workshop at Yale University. The paper stated that discount rates being used today were a result of Circular A4 of the U.S. Office of Management and Budget (September 2003). The circular mandated that all executive agencies and establishments conduct a regulatory analysis for any new proposal and, more specifically, a benefit-cost analysis, at the rates of both 3% and 7% (Mertens and Rubinchik 2006, 1). Private entities also use the rate of 7% to discount future values when conducting their analyses. These scholars indicated that both discount rates are rational choices when conducting a benefit-cost analysis. Since the San Marcos Conference Center Project is a public-private partnership, this benefit-cost analysis will consider the public rate, 3%, and the private rate, 7%, when examining the difference in project values using varying discount rates as mandated by the OMB Circular.

**Methodology**

The methodology used in this applied research project is a benefit-cost analysis. A benefit-cost analysis is a decision making tool that helps determine economic efficiency and encourages decision makers to evaluate whether the total benefits of a potential project outweigh the total costs. (McKenna 1980, 127). A benefit-cost analysis can help decision makers determine whether scarce resources should be used for a particular project.

The main purpose of conducting a benefit-cost analysis of a public project is to evaluate the social profitability of alternative uses of local government’s scarce resources (Galambos & Schreiber 1978, 62). Benefit-cost analyses allow public and government officials to formally identify the expected and unexpected benefits and costs of a project to create a recommendation
for implementation. In instances where a project, such as the San Marcos Conference Center, exists without the benefits of such an analysis, the results of this research will demonstrate whether the conference center decision corresponded with the expectations of the City Council in relation to the benefits outweighing the costs.

Due to the restraints of time and resources, this research will focus on a limited number of benefit and cost variables. Though there may be many other benefits and costs beyond the scope of this research, the assumptions and estimates will be made from the available data for the indirect economic variables associated with the San Marcos Conference Center project.

This project’s data will be acquired from the City of San Marcos, Hammons, and the San Marcos Chamber of Commerce. The City of San Marcos has been working with the Hammons Company for over four years to determine the appropriate monetary amounts and economic figures for the proposed conference center (City of San Marcos 2004-2007). Data analysis of available information from the City will be used to operationalize the benefits and costs of the project. Available data from the City includes preliminary budgeted costs of the project along with estimated revenue from hotel occupancy taxes and projected sales taxes. This research will convert relevant variables into monetary values to perform the actual analysis. Since most of the indirect benefits and costs are immeasurable in monetary terms, those indirect benefits and costs will be identified and explained in the final analysis of the project.

Additional estimates of the indirect benefits and costs of the project will be provided through structured interviews. This will be explained further in the Interview section of the prospectus and is located on page 30.
### OPERATIONALIZATION OF THE CONCEPTUAL FRAMEWORK

<table>
<thead>
<tr>
<th>BENEFITS:</th>
<th>MEASUREMENT:</th>
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<tbody>
<tr>
<td><strong>Direct Benefits:</strong></td>
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<tr>
<td>(R) Revenue from leasing the conference center</td>
<td>(R): The city will lease the conference center and allow Hammons to operate it for 25 years. The lease amount will be in the form of a franchise fee that varies every year and is dedicated to paying Hammons’ portion, 30%, of the total conference center cost. A detailed table showing the dollar increases will be provided by the City of San Marcos.</td>
</tr>
<tr>
<td>(RT) Revenue from hotel occupancy taxes</td>
<td>(RT): The revenue from hotel taxes is expected to increase due to the new hotel’s tax contribution to the City. A detailed table forecasting the actual amounts will be provided by the City of San Marcos.</td>
</tr>
<tr>
<td>(PT) Property Tax Revenue from the Hammons Hotel</td>
<td>(PT): The property tax revenue from the hotel project will be based on the tax increment reinvestment zone created by the city and county. The appraised value of taxable property for the Hotel (10 acres) is $1,306,800 as of 2006 and is expected to increase by one percent each year. A detailed table forecasting the property tax revenue from the City and the County will be included in the research. The forecasts will be provided by the City of San Marcos.</td>
</tr>
<tr>
<td>(ST) Sales tax revenue from:</td>
<td>(ST): A detailed table of expected sales tax revenue from 2008 to 2031 will be included in the research. The expected sales tax revenue forecasts will be provided by the City of San Marcos.</td>
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<tr>
<td>- Food</td>
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<td>- Beverage</td>
<td></td>
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<tr>
<td>- Telephone</td>
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<tr>
<td>(CI) Capitalized Interest</td>
<td>(CI): Additional funding from the Certificates of Obligation to fund construction costs. Estimates will be provided by the City.</td>
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<tr>
<th>COSTS:</th>
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<tr>
<td><strong>Direct Costs:</strong></td>
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<tr>
<td>(IC) Initial Construction Costs:</td>
<td>(IC): The total budgeted cost of the conference center is approximately $23 million. The City of San Marcos is responsible for 100% of the cost. The cost of connecting water and sewer lines to the existing infrastructure is included in the cost of the project.</td>
</tr>
<tr>
<td>(PL) Property Tax Loss from conversion of taxable land to non-taxable land</td>
<td>(PL): The land on which the conference center is being built will be tax exempt and will cost the city about $653,400 in lost property taxes. The value of the land will be provided by the City of San Marcos in its TIRZ guide.</td>
</tr>
<tr>
<td>(DR) Debt Retirement</td>
<td>(DR): The amount paid by the City and Hammons each year to retire the debt. An amortization schedule from the City of San Marcos will be provided.</td>
</tr>
<tr>
<td>(IN) Insurance coverage costs for the conference center</td>
<td>(IN): The insurance coverage costs for the conference center will be provided by the City of San Marcos.</td>
</tr>
<tr>
<td>(II) Infrastructure Improvements: McCarty Lane Improvements and Extension of Electric Utilities</td>
<td>(II): The infrastructure improvement costs to McCarty Lane and the extension of Electric Utilities will cost $2,073,875. Improvements to McCarty lane and the extension of utilities will be paid for by the City of San Marcos.</td>
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### OPERATIONALIZATION OF THE CONCEPTUAL FRAMEWORK: CONTINUED

<table>
<thead>
<tr>
<th>DECISION CRITERION</th>
<th>MEASUREMENT:</th>
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<tr>
<td>(PV) Present Value of Benefits</td>
<td>(PV): The present value of the project is derived by using the annual capital flow, which is the annual benefits minus annual costs, in a formula with the discount rate and the useful life of the project in years. These variables will be used to determine the present value of the project today in future dollars.</td>
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<tr>
<td>and Costs</td>
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<tr>
<td>(NPV) Net Present Value</td>
<td>(NPV): The Net Present Value is derived from the subtraction of the Present Value of the Benefits and the Present Value of the Costs.</td>
</tr>
<tr>
<td>(BCR) Benefit-Cost Ratio</td>
<td>(BCR): To find the BCR the Present Value of Benefits and Costs must be divided by the Initial Capital Outlay of the project.</td>
</tr>
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### Benefits

#### Direct Benefits

Conducting document analysis of available and existing data from the City of San Marcos will allow operationalization of the direct benefits of the conference center project. The project’s direct benefits include estimated revenue from leasing the conference center and estimated revenue from sales tax and hotel occupancy tax. This information will be provided by the City of San Marcos and Hammons Development encompassing the time period from the opening of the conference center until the end of the lease term.

#### Leasing of the Conference Center

The City of San Marcos will lease the conference center to Hammons for 25 years. This lease will allow the private developer to operate the conference center while marketing the facility to organizations and associations without any additional costs to the City. Hammons will assume responsibility of the conference center throughout the term of the lease and will be responsible for all associated operating and maintenance costs. The total lease payments made by Hammons to the City will equal 30% of the total debt of the conference center. The City of San Marcos is expecting to make no additional revenue directly from Hammons’ lease since all of the payments will go toward retirement of the City’s debt.
**Hotel Occupancy Taxes**

Along with conference attendee’s spending money to enhance their experience, they also are providing money to the city by staying in a local hotel and paying hotel occupancy taxes. Conference centers located within hotels or in close proximity expect to receive greater patronage and, therefore, greater revenue from hotel occupancy taxes. Additional local government revenue in the form of hotel occupancy taxes are incorporated into the final price of the hotel room. With the new hotel being built in conjunction with the conference center, hotel occupancy taxes are expected to increase. It is important that cities that build conference centers provide adequate hotel/motel space in order to increase the hotel occupancy taxes for the city. An increase in hotel occupancy tax revenue is a primary reason why cities create new or expand existing conference center facilities.

**Property Tax Revenue**

The property tax revenue from the hotel site will benefit the City of San Marcos. The 10-acre property was originally assessed as agriculture property by the City of San Marcos in 2006 at $1,306,800. Since the land purpose has changed, the value is expected to increase approximately one-percent each year. No property tax abatement was granted to Hammons. Although residential property values are expected to rise significantly more than one-percent each year, the TIRZ has established a limit on the amount of increase allowed on the property throughout the life of the zone. The five-acre tract owned by the City is non-taxable and will not be included in property tax revenue generated by the project. The property tax revenue from the hotel site is part of the Tax Increment Reinvestment Zone (TIRZ) and provides reimbursement to the City for the project’s construction costs. The TIRZ took effect August 15, 2006, and will terminate on September 30, 2031 (San Marcos 2006- TIRZ, 8).
**Sales Tax Revenue**

Sales tax revenue is one of the most sought out benefits of building a conference center (Talbert 1998, 14). Conference attendees also will purchase items that produce additional tax revenue for the city in food, beverage, and telephone call purchases. Sales tax revenue is a direct benefit to the city and also assists in stimulating the local economy by increasing dollars to local businesses. The City of San Marcos has estimated the expected sales tax revenue from 2008 to 2025, but this analysis will extend the sales tax revenue forecast to the end of the lease term in 2031.

**Capitalized Interest**

Capitalized interest will be accrued from the issuance of the Certificate’s of Obligation between the City’s holding of the issued amount until financing the builder for the project’s costs. This interest is included only during the first year of construction, FY 2007, because it is only accrued during that period. Capitalized interest is additional revenue that is typically applied to funding a project and is not part of the initial project cost or included in the total amount of issued Certificates of Obligation.

Along with the direct benefits of a project, the indirect benefits also are essential when determining if the overall benefits will outweigh the costs of the project. Though indirect benefits are impossible to measure, they should be considered when determining the overall benefits of a project.

**Indirect Benefits**

This analysis will not operationalize the indirect benefits of the conference center project in monetary terms, but will instead conduct document analysis of available and existing data as clarified by interviews with City of San Marcos officials. The indirect benefits from job creation, indirect development, and property and sales tax revenue from those developments near
the conference center are virtually immeasurable since the development does not currently exist, but will be considered qualitatively in the conclusion of the research. However, additional benefits associated with conference centers is expected to improve the local economy.

*Job Creation*

Hammons is expected to create approximately 250 jobs as a result of the Hotel and Conference Center project. Since the variable of job creation cannot be measured easily in monetary terms and will not affect the City’s payroll, this variable will not be included but will be discussed at the conclusion of this analysis. Interview results confirmed that the City of San Marcos did not take this factor into consideration when contemplating building the conference center. Typically, the City only considers job creation in private manufacturing projects, since they tend to provide better wages to middle class individuals within the community.

*Indirect Development*

Indirect or secondary development is expected to boom within the conference center area. Though the City of San Marcos did not consider indirect development in its assessment for building the conference center, City officials articulated that they were aware that such development would arise in close proximity to the project. Many cities, such as San Marcos, construct conference centers in open areas in hopes of expanding and increasing development. Along with additional revenue from sales taxes, property taxes from these indirect developments can make a substantial impact on tax revenue.

*Property Tax and Sales Tax Revenue from Indirect Development*

As new development is created, additional property taxes are collected, boosting the local budget. In instances where development occurs in areas previously zoned for agricultural purposes, property tax revenue will increase significantly as property is rezoned for commercial
or residential development. This analysis will only consider and discuss the expected effect of property tax and sales tax revenue from indirect development on a non-monetary level. The indirect benefits of the conference center project are expected to provide a substantial benefit to the City, but estimates by the City or Hammons were not included in the San Marcos’ feasibility study.

Costs

Direct Costs
Conducting document analysis of available and existing data from the City of San Marcos will allow operationalization of the direct costs of the conference center project. The most current city data will be used in the analysis. The City of San Marcos and Hammons have estimated the project’s initial construction costs, annual maintenance, and annual operating expenses from the beginning of the project to the end of the lease agreement. Each of the direct costs is estimated in monetary amounts, but the indirect costs associated with the project will be qualitatively considered in this analysis and not converted into monetary terms.

Initial Construction Costs
The initial construction accounts for the largest share of the project’s cost. While the City is responsible for 100% of the cost, Hammons Development has agreed to pay for thirty-percent of the total costs of the project through a guaranteed lease term of twenty-five years. Initially, the City stated the project would cost $20 million, but Taxable Certificates of Obligation for $6,819,538 and Non-Taxable Certificates of Obligation for $16,084,556 were issued on September 5, 2006, totaling nearly $23 million (San Marcos 2006- TIRZ, 21). Since the City is ultimately responsible for the full issued amount, this analysis is based on the $23 million cost of the project.
Initial project costs include the land purchase, construction labor, materials, supplies, and any other costs associated with the evaluation and safety testing of the structure. The builder, Broaddus & Associates, of the San Marcos Conference Center expects the cost to exceed the twenty million dollar threshold stated initially by the City once associated fees, cost of work, construction contingency\(^4\), owner’s contingency costs\(^5\), consultant fees\(^6\), and testing and evaluation costs\(^7\) are derived near the end of the construction process.

Due to the Agreement, the initial project costs to the City are expected to stay on budget. As of fall, 2007, the project is on budget and on schedule for completion (Landis 2007, 1). The costs of building and maintaining a conference center may exceed the initial construction expenses and add an overwhelming financial burden to government entities. Excessive costs in conference center development are the common reason for private developers to partner with governments in large and expensive ventures.

*Property Tax Loss*

The City of San Marcos also must consider the property tax loss that the city-owned land of five acres will create. Since city-owned land is not taxable, a loss on property tax revenue is expected. The conference center tract of land is currently valued by the Hays County Appraisal District at $653,400. The property value is expected to increase by 1% each year and is set by the TIRZ.

\(^4\) Any changes to the agreed cost of the project that is associated with unforeseen changes in the costs of building materials and/or supplies. This contingency is set forth in the budget of the project’s cost as a buffer for any unforeseen builder costs and is refunded if not used.

\(^5\) Any contingency’s or changes in the design of the project that the owner requests and is not set within the initial contract agreement.

\(^6\) Fees that are associated with a project when technical expertise is needed to advise on problem areas.

\(^7\) The costs associated with a project when the structure must be evaluated and tested by an outside party. Evaluation and testing ensures a sound and safe project and is required to gain a certificate of occupancy.
**Annual Maintenance and Operating Costs**

The annual maintenance and operating costs\(^8\) for the project can be very expensive and affect negatively the overall revenue of conference centers. In this analysis, annual maintenance and operating costs for the conference center will not be included since Hammons has agreed to bear the burden of these costs in the lease agreement. The city only will be held liable for any major appliances or equipment, but since the majority of the appliances and equipment are under extended warranties (five years or over), these cost estimates will not be reflected in the analysis. The City will be held liable for maintenance and operating costs of the project after the lease has expired, but for the purpose of this analysis, these variables will not be considered beyond the life of the lease.

**Insurance Coverage**

Under the contractual agreement signed by the City and Hammons, each entity must provide insurance coverage for their own property even though the conference center will be leased to the private party (San Marcos 2007-Contract agreement). The City is required to hold sufficient insurance to cover the value of the conference center throughout the life of the project. An estimate of the insurance costs for the project has been completed by the City of San Marcos.

**Infrastructure Improvements**

The site of the conference center project also requires infrastructure improvements including the extension of basic utilities and the expansion of roads. The infrastructure improvements were not considered in the initial construction costs of the project but must be included in the analysis. Since water and waste/water lines already extend to the site, the cost of construction includes only tapping into the existing lines and laying pipe to the facility. The cost

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\(^8\) Costs associated with maintaining and operating the project, including employee salaries, upkeep of the grounds, general supplies, utilities, and other pertinent costs associated with hotel and conference centers.
of connecting the water and waste/water lines is the responsibility of the city, but the associated costs are included in the total construction costs of the project. The local gas supplier, CenterPoint Energy, will pay for the gas lines leading to the hotel and conference center and these costs will not be included in this analysis.

The City will be responsible for extending electric utilities out to the project site along with expanding McCarty Lane. The amount of $73,875 to extend electric utilities to the hotel and conference center site includes the installation of poles, lines, and transformers. The contractual agreement of the project obligates the City to pay for the cost of extending electric utilities. The additional expense of expanding McCarty Lane has placed an additional financial burden on the City.

During the spring of 2007, the City of San Marcos put a bond package on the ballot that would expand many roads around the city (including McCarty Lane). When the bond package failed, the City was required, under contract, to fund the expansion of McCarty Lane from I-35 East to the end of the property line. The cost is not expected to exceed two million dollars. Since the road improvements are required under the contractual agreement, this cost will be considered in the analysis of the project.

The conference center project also must anticipate the indirect costs associated with these types of projects. Indirect costs can cause many conference centers to fail in cities of all sizes and must be considered when choosing the site for the project.

**Indirect Costs**

The indirect costs of the conference center project include traffic congestion, the environmental impact of the development, and competition from other conference centers in close proximity. Since the effects of indirect costs are different in each area, structured
interviews will be conducted with city officials to determine their potential effect on the City. The indirect costs of the conference center are essential in determining the social aspects of the project on the community.

Traffic Congestion

Many cities find themselves plagued by traffic congestion in conference or convention center areas. The unexpected vehicle and pedestrian traffic must be considered when selecting the most appropriate site for the project to minimize its effect on the area. San Marcos officials have stated that traffic congestion would be minimal because of the unpopulated location of the project. Since the conference center site is located in an undeveloped area of I-35, traffic from conference attendees should not be a factor. Though indirect development is expected to be placed in the area, traffic conditions cannot be estimated prior to their construction. The expansion of McCarty Lane and the proposed expansion of the I-35 frontage road should alleviate traffic congestion within the conference center area.

Environmental Impact

The environmental impact of building this type of project can be substantial for the community and the state. The San Marcos Conference Center’s previous location above the San Marcos River Head Waters was found to be a major threat to the environment and the San Marcos River. Public outcry and significant opposition to the proposed conference center location prompted officials to move it to its present location on I-35 and McCarty Lane. The current site was found to have minimal environmental impact on the area and the community. The relocation of the project because of environmental concerns will be discussed in the conclusion but will not be measured in the analysis.
Competition from Other Conference Centers

Competition due to conference centers in close proximity to the San Marcos facility can have a considerable impact on the success of the project. Though City officials feel that the project is more luxurious than others in the area when comparing size and accommodations, the fact that many other conference centers are located in close proximity to San Marcos could have a substantial effect. Large conference centers in San Antonio and Austin have a significant advantage in attracting conferences from around the nation. Though the San Marcos Conference Center is expecting to host more association and business meetings, as opposed to exhibitions or trade shows, the locales of New Braunfels, San Antonio, and Austin could have significant effects on the project’s viability as they pursue similar markets. Although the effect of competition cannot be measured, this analysis will consider the effect that competition may have on the facility. The City of San Marcos will have to compete with other markets in close proximity when attempting to attract conferences to the city.

Discount Rate

The discount rate used in this benefit-cost analysis is critical to the results. The outcome of the present value will vary significantly with the use of differing discount rates. Since the San Marcos Conference Center Project is a public-private partnership, this analysis will be evaluated using the rates of 3% and 7% to examine the differences in the results. As stated by Mertens and Rubinchick (2006, 1), the OMB must conduct a regulatory analysis including a benefit-cost analysis for all new proposals at the rates of both 3% and 7% to determine a project’s viability.

Decision Criterion

After the benefit and cost variables have been measured in monetary terms, they can be assessed using the appropriate decision criterion. The primary decision criterion will be the Net Present Value, representing the present value of the project in future values minus its initial cost.
If the project is beneficial for the city and the economic benefits outweigh the costs, the net present value will be positive. A project’s present value is essentially the value of a project today represented in future dollars that can be reduced due to inflation, uncertainty, risk, and currency value (Gupta 1994, 345). Since the present value and net present value calculations take into account both the time and value of money, they are the most appropriate criterion to use when conducting a benefit-cost analysis.

The benefit-cost ratio and the pay-back period also will be discussed in the research project but will not be significantly weighted in the final analysis of the project. The benefit-cost ratio (BCR) is a measure that is not influenced by the size of the investment but compares alternatives of different sizes (McKenna 1980, 149). If the value of BCR is determined to exceed one, then it is a viable project, but if the BCR is found to be below one, then the project is not economically feasible and not recommended since the costs outweigh the benefits.

The pay-back period is the least influential of the decision criterion because it does not take into account the time and value of money (Mikesell 2007, 273). As a result, the payback period will not be analyzed in this research project, and the data obtained from the city’s estimate of the payback period will be substituted. The payback period can prove useful when comparing similar projects and when a shorter time frame is recommended (Mikesell 2007, 273). The decision criterion and methods listed in the operationalization table show the formulas that will be used to assess the San Marcos Conference Center Project.

**Interview Questions**

Indirect (external) social benefits and costs are difficult to identify and analyze with literature and data alone. Using structured interviews, information will be gained that is not provided by the City of San Marcos or other relevant sources. The structured interviews will be
completed with officials from the City of San Marcos to attempt to identify benefits and costs not anticipated by the available information. Interviews with appropriate City officials include Dan O’Leary, City Manager, Jamison Collette, Project Manager of the Conference Center and Assistant City Manager, Rebecca Ramirez, Director of the Conference and Visitors Bureau, and Bob Higgs, the Director of San Marcos Electric Utility, will be completed to gain insight on what the expectations are for the conference center. The questions asked in the interviews with the director of the electric utility and the director of the conference visitor’s bureau will vary since these officials do not know the specific details of the project.

Since the City Manager and the planning section of the City have been working on assessing and developing the conference center project, these interviews will provide a narrower scope of what the city wants to achieve by proceeding with the development. The structured interviews will allow the researcher to gain direct qualitative information from officials that are directly involved with the conference center to provide more accurate and valid research. Table 2 contains a sample of the interview questions.

**Table 3: Sample Questions for Proposed Structured Interviews**

<table>
<thead>
<tr>
<th>Structured Interview Questions: To clarify questions about the conference center project from factors and variables mentioned in the City of San Marcos’ Data</th>
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</thead>
<tbody>
<tr>
<td><strong>Questions</strong></td>
<td><strong>Response</strong></td>
</tr>
<tr>
<td>1. What will the effect of traffic congestion from the conference center have on the city? i.e. Police services</td>
<td></td>
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<tr>
<td>2. Are there any estimates on the indirect or secondary development that will occur from the project?</td>
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<tr>
<td>3. Are property taxes expected to rise in this area?</td>
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<tr>
<td>4. Is competition from conferences centers in close proximity a risk to San Marcos? i.e. New Braunfels, Austin, San Antonio. Why or Why Not?</td>
<td></td>
</tr>
<tr>
<td>5. What is the environmental impact of the conference center at its present location?</td>
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</tbody>
</table>
Structured Interview Questions: Continued

6. Is the project currently on budget? If not, why?

7. Are infrastructure improvements to McCarty Lane and to the utility lines being paid for by the city? If so, how much will it be?

8. Are there any expected meeting events to be booked when the conference center opens?

9. Has there been interest from any entities about using the conference center for their event?

10. Is limited hotel space a challenge for the city? If so, how is this expected to be resolved?

11. How does the city estimate the benefit of job creation from a development such as the conference center?

12. Is there any groups or people of major opposition to the project?

13. Is there any unforeseeable benefits or costs not mentioned that should be covered?

Conclusion

The research design was broadened to include as many direct and indirect variables of the project as possible, even those that cannot be converted to monetary values. It is anticipated that the results of this research will encourage government entities to use benefit-cost analysis to provide additional information prior to making a decision on a specific capital improvement project. Even when the measurement of variables is imperfect or capital projects already are in progress, benefit-cost analysis can provide decision makers with credible expectations about the outcomes.
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