



MEMO

To: Ron Whitehead, City Manager
From: Randy Moravec, Chief Financial Officer
Re: Proposed Hotel
Public/Private Partnership (HP³) Policy
Date: January 27, 2010

Introduction

The Town of Addison has been approached by two of its hotels with requests for public participation in expansion of their meeting room facilities. The requests are based on the premise that public incentives are needed to make the projects financially feasible. It is in the Town's interests to have hotels that are competitive in the business and tourist travel market. The Town's mission is to "maintain a dynamic, progressive quality atmosphere in which to work, play and live with an emphasis on balanced growth." In support of this mission is the city goal to "provide for a diversified business climate" by pursuing "economic development through the use of innovative programs of work that seek to emphasize retention and the expansion of existing businesses." A vibrant and robust hotel market in Addison will also benefit Addison's many restaurants and retail establishments. In summary, it is in Addison's interests to develop a program to protect and enhance the economic viability of its hotels in the extremely competitive Dallas / Ft. Worth regional hospitality market.

Legal Basis

Home rule cities in Texas have been given broad latitude to encourage economic development. One statute, Chapter 380 of the Local Government Code, gives cities the ability to establish and provide for the administration of programs for "making loans and grants of public money and providing personnel and services of the municipality, to promote state or local economic development and to stimulate business and commercial activity in the municipality." Chapter 380 was enacted pursuant to Article 3, Section 52-a of the Texas Constitution, which authorizes the legislature to "provide for the creation of programs and the making of loans and grants of public money, other than money otherwise dedicated by this constitution to use for a different purpose, for the public purposes of development and diversification of the economy of the state, the elimination of unemployment or underemployment in the state... or the development or expansion of transportation or commerce in the state."

In the past, to encourage a major tenant to move into a retail site, the Town participated in a program to provide an economic development grant equivalent to 50 percent of the sales tax

above a minimum threshold amount to a retailer. The Town is currently considering an economic development incentive to a significant commercial enterprise to locate its offices within the Town. Subject to certain conditions (e.g., entering into an agreement to provide an economic development grant which includes, among other things, provisions to ensure that the economic development purpose of the grant is carried out), the Town could certainly use general property tax or sales tax to encourage development.

However, it is less clear that the Town can use hotel occupancy tax revenue to facilitate private economic development. Chapter 351 of the Tax Code details the use of hotel occupancy tax revenue. While this tax can be used to finance public convention and conference facilities, it generally does not allow for the use of hotel occupancy tax funds to expand or improve hotel facilities. Because of this limitation, the Town would facilitate development with property or sales taxes from the General fund.

Scope of Public Investment in Hotel Projects

The scope of the HP³ program in Addison is limited to existing hotels that strive to attract additional business through the expansion of their facilities. Eligible projects include addition of guest rooms and/or expansion of meeting or ballroom spaces to enhance a hotel's ability to host conferences. The program does not include rehabilitation or renovation of existing facilities.

Process for Public Funding of Private Hotel Development

Critical to the decision to direct public funding of private developments is the determination of the minimum level of benefits the Town hopes to achieve with any public/private partnership. For example, with the Addison Circle and Vitruvian Park developments, in which the Town funded supporting public infrastructure, the Town sought and achieved a 20:1 ratio of private investment to public investment. With the Vitruvian Park development, it was projected that the Town would receive a net present value benefit of \$5.3 million over a 25-year period with total property and sales tax revenue exceeding the costs of servicing debt associated with \$40 million of infrastructure investment.

It is anticipated that owners/managers of hotel properties will consider facility expansion if they believe that the project will generate additional income to the property. Expanded properties should generate additional guest room rentals, meeting space rentals, equipment rentals and catering/bar fees. The Town would also benefit from the additional revenue generated by the project. The Town would receive seven percent of guest room rentals through the hotel occupancy tax and one percent of revenues generated by meeting room rentals and catering fees. Because facility expansion is expected to increase the hotel's property value, the Town would receive additional property tax.

A hotel applying to the Town's HP³ program must indicate in its application the amount of additional revenue, by category, it expects to receive from the expansion project. The minimum threshold for public investment in the HP³ program is calculated on a net present value (NPV) over a ten-year period. The Town will not invest in projects that fail to return a minimum ten percent increase in average annual occupancy and sales tax revenues generated by the property. The level of public investment will also not exceed 20 percent of the hotel's capital investment.

Distribution of Public Investment

The demands on the Town's General fund limit the Town's ability to make initial investments in hotel expansion projects. Therefore, it is anticipated that the Town's investment will be distributed to the hotel as an annual payment from the General fund. The economic development payment will be remitted to the participating hotel following, among other things, receipt of a certified report from the hotel that confirms income generated by the hotel in excess of a base agreed to by the hotel and the Town from annual income statements preceding the facility expansion. The provision of such a report will be reflected in an agreement between the Town and the hotel, which agreement will include other provisions regarding the payment and use of the funds, including provisions for reimbursement of the funds if the hotel fails to comply with the terms of the agreement. The payments can be an amount equivalent to up to 50 percent of the actual *additional* tax revenue the Town received from the expansion project. The payments will be for a period not to exceed ten years and be remitted only to the hotel property owners approved in the original application. Transfer of ownership of the hotel property voids the HP³ program hotel occupancy tax remittances.