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FREDERICK'S $70 MILLION DOWNTOWN HOTEL & CONFERENCE CENTER: BOON OR BOONDOGGLE?

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CITY OF FREDERICK LEADERS HAVE LONG WANTED A NEW DOWNTOWN hotel. The city's last grand downtown hotel, the Francis Scott Key, closed decades ago, along with a handful of smaller and more modest facilities. Today, Frederick's urban core is served only by a smattering of bed-and-breakfasts and listings on Airbnb. In other respects, the downtown has experienced strong revival in recent decades, with trendy shops and restaurants, new office buildings and town houses, while retaining the walkability and charm of a quirky, unplanned town dating back to the early 18th century.

The lack of a hotel is not the product of insufficient demand or market failure; developers have indicated interest in such a project. Rather, it's the result of the difficulties of carrying out such a project given the city's considerable impact fees and regulatory barriers, especially those imposed by its Historic Preservation Commission.

To overcome those obstacles, Frederick leaders are pursuing a grandiose Downtown Hotel and Conference Center (DH&CC) project that is currently estimated to cost about $70 million. They want Maryland taxpayers to subsidize roughly $16 million of this, city and Frederick County governments $10 million, while private "partners" would contribute $44 million.

The resulting complex would be an "upscale," "full-service" hotel of 200+ rooms that would feature a business center, gym, indoor pool, day spa, and multiple restaurants and bars. A city-owned conference center of 24,000 square feet would be part of the complex, the overall facility being 155,000 square feet.

Though there is undoubtedly some unmet demand for lodging in downtown Frederick, the case is weak for such a large, high-end facility with all its attached frills. Frederick officials justify the project by claiming it will "spark" a "renaissance" over nearby blight as well as provide a stream of positive economic "impacts" for the downtown by way of new spending, jobs, and revenues. It is a familiar political pitch, but the experience of other cities with similar projects suggests skepticism about such hyperbole. The list is dismal: Rocky Gap, Cambridge, Ocean City.

In recent years, voters in Maryland and across the nation have voiced their disgust at business dealings between government officials and wealthy special interests. Intended or not, Frederick's proposed DH&CC is a relatively small example of such cronyism: Local politicians will boast of the project they delivered. Business interests will prosper from deals involving the facility's construction and operation. But state and local taxpayers will be saddled with part of the cost for the facility's construction, they will sacrifice tax revenues, and then they will likely subsidize its operations year after year, when its revenues fall short of the rosy scenarios painted by project consultants. Meanwhile, other investors in the downtown will line up expecting their turn to dip at the public trough, and those businesses that are only capitalized privately will struggle to compete. State financing of the project also allows Frederick leaders to avoid making difficult but important reforms to the downtown's bizarrely complex zonings, expensive impact fees, confused historic preservation guidelines, and other regulatory barriers—reforms that would promote healthy economic growth in the city.

BACKGROUND

The city of Frederick has a population of 68,000 and its broader metropolitan area has a population of 142,000. It is located 35 miles outside the Washington Beltway, which services the national capital area, one of the wealthiest and most cosmopolitan in the world. It is a similar distance from Baltimore, whose metro population is 10 times Frederick's size. Both are major tourist destinations with plenty of attractions and convention and conference facilities of their own, all more conveniently located than Frederick.

On the lodging front, the Frederick area presently has some 20 hotels offering about 2,200 rooms. Most of them are one to four miles from the downtown and arranged just off the highways that intersect in and around the city: Interstate 70 that runs east to Baltimore and west to Hagerstown, I-270 that runs southeast toward Washington, and U.S. 15 that runs south to Leesburg, Va., and north to Gettysburg, Pa. All of these hotels are beyond easy or inviting walking distance to the downtown, but are a very short hop by cab, shuttle, Uber, or self-drive to one of five downtown parking garages.

The lack of a downtown hotel is unusual for a city that promotes itself as a visitor destination both "historic and hip." Annapolis, which is half the size of Frederick, has four downtown hotels, and three others within easy walking distance of downtown. Alexandria, Va., is similar. Comparable cities in the region include Lancaster, Pa., which has five downtown hotels, Charlottesville, Va., with three, and Gettysburg, Pa., with five.

Frederick revival Like many other American cities, Frederick has experienced decline and renewal over the past half-century. For most cities, the decline was fueled by suburbanization as post-war households prospered, had children, and moved to the suburbs where they could buy a single-family home on its own lot. Urban manufacturing, distribution, and retailing likewise exited as firms sought larger lots better connected to the highways. Welfare housing projects and civil unrest of the late 1960s and early 1970s further fueled this outmigration in Frederick as elsewhere. Many drab asphalt parking lots are a legacy of city-required parking spaces for now-departed businesses and residences.

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In Frederick's case, natural disaster contributed to the city's decline. Carroll Creek, a major tributary of the Monocacy River that flows through the downtown area, suffered two serious floods in the 1970s, causing more abandonment of the downtown.

But Frederick underwent a marked renewal beginning in the 1990s, attributable in part to a major flood control and public works project along the creek. Modeled on San Antonio's River Walk, the Carroll Creek Linear Park is a rare example of a grand public work working really well: four giant concrete conduits carry floodwaters safely under the city, while regular creek water is fed into an attractive canal with water lilies, carp, and ducks, flanked with landscaped promenades and fountains. Pedestrian bridges over the canal complement the urban-style park.

Buoyed by this project and the remarkable economic growth of the broader D.C. metropolitan area over the past two decades, Frederick has prospered. A bunch of mixed-use buildings—mostly restaurants and small businesses at ground level with office space above—along with a major condominium complex, a major library, and an arts center, have been built in the downtown area over the past two decades. This impressive development, worth $100 million or so, occurred with little public funding apart from the Carroll Creek project itself.

But Frederick's downtown recovery is only about half done. Along with the acclaimed restaurants, attractive bars, antique malls and small specialty stores, and some very attractive streets of 19th century townhouses, there is still considerable urban blight. Poorly maintained streets, empty and decaying buildings, unkempt alleys, and barren expanses of asphalt mar the cityscape. Amid gentrification there is still poverty. The revival is incomplete.

PUSH FOR A DH&CC

Frederick leaders' pursuit of a DH&CC is motivated in part by an understandable desire to further the downtown renewal. This motivation colors the language these leaders use to describe the project: it will be "transformative," a "catalyst" for economic growth, will "jump-start" development, and will serve as an "anchor" for further renewal.

These metaphors reflect a theory of "positive economic externalities"—the notion that some activities can bring benefits to entities not directly involved in those activities. In this case, development on one empty lot supposedly will spark development on adjacent lots, spreading out through blighted parts of the city. 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.

Viability Prima facie, it appears that one or more smaller downtown Frederick hotels would be economically viable—and without public financial support.

Matt Seubert, a certified public accountant specializing in hotel finance, examined the Frederick market and has stated publicly that the city appears to be a good location for at least one "boutique" limited-service hotel of about 70 rooms and 5,000 square feet of meeting space.[1] Such a project would carry a price tag of $12 million to $14 million—assuming some accommodations with the city's regulatory obstacles—which is well within the capabilities of private hotel financing. This facility could sit on any of 15 to 20 currently empty or underutilized sites in the downtown, most of them more conveniently located than the site proposed by the city for the DH&CC. Further, this private project would increase the total number of hotel rooms in the area by about 4 percent, which would not disrupt the viability of the area's existing lodging providers.

In contrast, Seubert has warned, the DH&CC proposal of a high-end, full-service hotel of 200+ rooms and a 24,000 square-foot conference center is not viable under standard hotel industry metrics. Project supporters apparently intend for the hotel to draw affluent business and pleasure travelers from the D.C. area. Many D.C.-area residents do visit Frederick for pleasure regularly, but it's unclear how many of them would stay the night at a location that is less than an hour's drive from home. Likewise, it is unclear how many D.C. professionals would use the facility; the federal government, for instance, has a policy that it will not cover hotel stays for employees who travel less than 50 miles from their workplace.

Industry metrics indicate the $70 million DH&CC project would have a value of just $36 million at opening, according to Seubert. That means nearly half of the proposed expenditure would be wasted. The DH&CC would also increase Frederick hotel capacity by 10 percent, which could be disruptive to existing investor-funded hotels.

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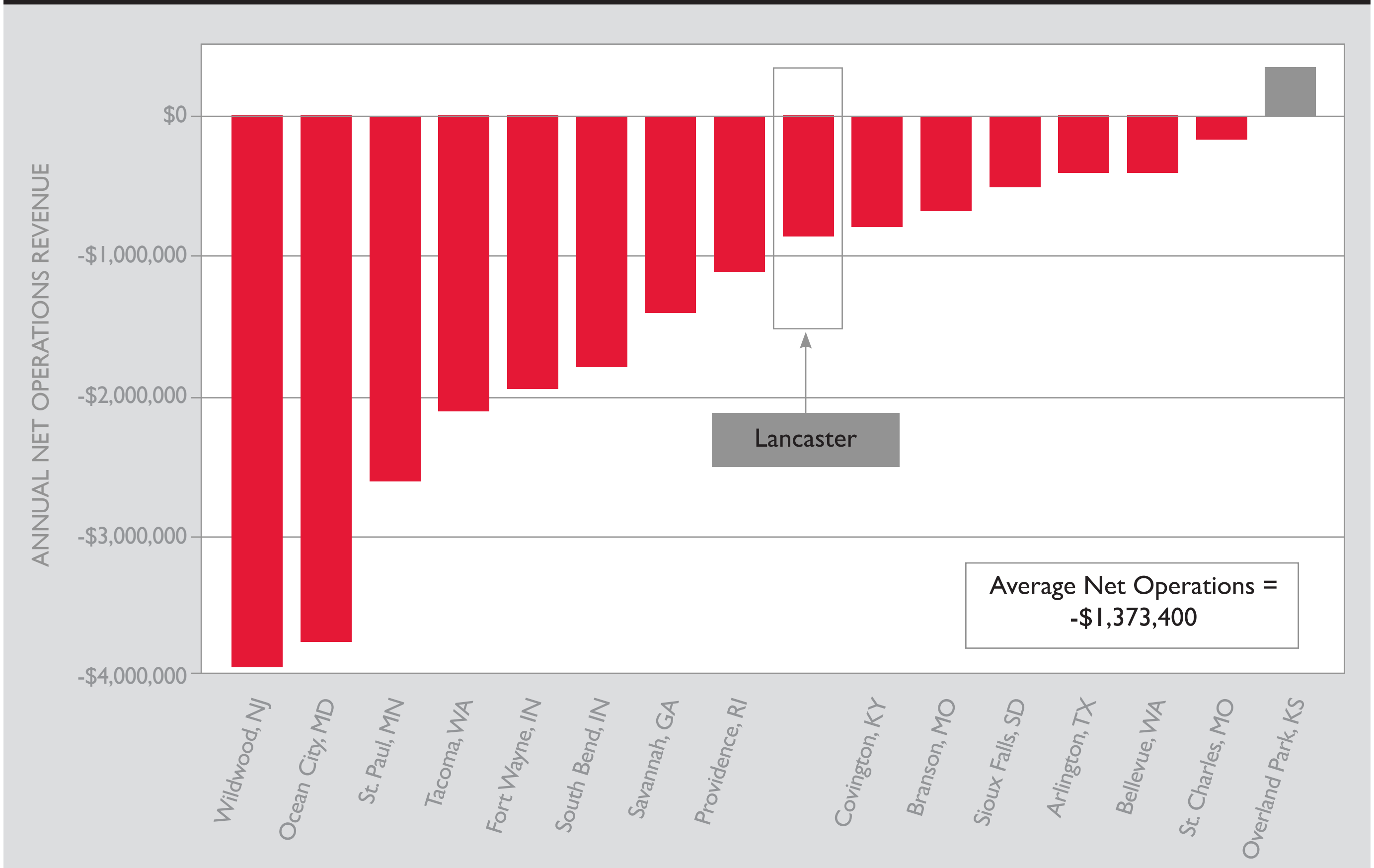
Beyond industry metrics, the experience of smaller cities like Frederick with similar projects raises doubt about the DH&CC's viability. One project that supporters love to cite is the Montgomery County Conference Center, also known as Bethesda North, which has covered its operating expenses since its opening in 2004. But Frederick is not North Bethesda, located in a county four times Frederick's size, convenient to the District of Columbia, right off the Capital Beltway, and five minutes' walk from a Metrorail stop.

A comparable project to the DH&CC is the public-subsidized downtown hotel and conference center in Lancaster, Pa. Like Frederick, Lancaster has a historic downtown and it too is a popular day trip from major metropolitan areas (Baltimore and Philadelphia). Opened in 2009, the Lancaster facility earns less than $2 million in annual revenue, yet has around $5.5 million in operating costs and debt service of $2.7 million. The facility needs about $6.3 million in yearly taxpayer subsidies to stay open.[2]

After a government financial crisis in Lancaster raised concerns about continuing those subsidies, entertainment facility consultancy Conventions Sports and Leisure (CSL) of Minneapolis, Minn., was hired to analyze the facility's losses. The resulting report[3] is sobering. After examining Lancaster and 14 comparable facilities, CSL found that all but one could not cover their operating expenses. And the one that did could not also cover its debt service. Those findings are depicted in Figure 1, which is reproduced from the CSL report. Put simply, Lancaster's experience is typical, and the Frederick DH&CC would likely be yet another white elephant.

FIGURE 1 SUMMARY OF NET FINANCIAL OPERATIONS—COMPETITIVE AND COMPARABLE FACILITIES



Note: Data include only revenues and expenses associated with facility operations. Items such as parking, debt service, operating subsidies and other "non-operating" activities have been excluded. Source: CSL, Facility Management, 2012

ECONOMIC IMPACT?

However, economic viability has never been of much interest to the DH&CC's backers. The city's Downtown Hotel Advisory Council established the following goals[4] for the project:

- Service citizen and business needs.
- Drive economic impact in terms of tax revenue generation and job creation.
- Induce tourism, overnight stays, and new conference activity.
- Be a catalyst for continued downtown revitalization and growth.

Those are nice hopes, but the real test of any business like a hotel complex is whether it can earn in revenue from customers enough to cover all its costs and return something on the investment. If it cannot, it is unclear whether the facility is worthwhile. And it will certainly be a chronic burden on the public in the form of taxes that will be needed to keep it open. Moreover, if a hotel—albeit more modestly sized and outfitted—could be financed at no public expense, then why is the city forgoing that opportunity?[5] Despite such questions, Frederick city leaders seem fixated on the taxpayer-supported DH&CC, whose shape evolved over seven years of insider politics.

In the promoters' narrative, this project is sound public investment. According to one of the consultancies that DH&CC supporters retained, it would provide the following annual benefits[6]:

- $16.5 million in direct spending by facility patrons, plus additional indirect and induced spending of $9.4 million, for a total of $25.9 million
- 280 jobs created, producing $9 million in earnings
- $1.9 million in state and local tax revenues

These numbers seem wildly optimistic. A 200-room hotel that the report assumes will have a 72% occupancy rate will have 52,560 room-nights rented each year. If new direct spending at the facility is projected to be $16.5 million, then that means each room-night would generate $314 in sales. No doubt, the DH&CC will find revenue streams from non-lodgers (e.g., locals' use of meeting and banquet space, the spa, and the facility's bars and restaurants), but the $314 figure is stunning. This direct spending is then supposed to spark further economic activity as the DH&CC's staff, suppliers, and service people spend their incomes. No doubt this will happen to some extent, but the report's assumed 1.57 multiplier is farfetched.

Moreover, it's unclear from the report whether these figures represent gross or net economic effects on the Frederick area. Gross figures obscure the fact that a good portion of the hotel guests and conferees for the Frederick DH&CC would simply be business transferred from existing establishments in the Frederick area. Instead of lodging just off the interstates, the visitors would now lodge downtown—which is a clear benefit for the downtown, but a loss for the outlying area and of no net benefit to the area overall. Likewise, an event held at the DH&CC that would have been held at the privately owned Holiday Inn or Ceresville Mansion would also be of no net benefit.

Misleadingly, reports like those commissioned by the DH&CC supporters rarely present net benefits. A longtime analyst of these reports, Texas A&M University Distinguished Professor John L. Crompton, characterizes the reliability of these reports this way:

> Most economic impact studies are commissioned to legitimize a political position rather than to search for economic truth. Often, this results in the use of mischievous procedures that produce large numbers that study sponsors seek to support a predetermined position.[7]

Mainstream economics sees the purpose of economic activity not as providing narrowly observed "impacts," but as providing an array of goods and services at a competitive price to consumers while, over time, covering costs fully and generating a return on investment. Hence, the goals outlined by the city's Downtown Hotel Advisory Council are of questionable public value and may be wholly illusory when the overall effects of the DH&CC on the Frederick area are considered. This is a formula for wasteful, unproductive investment, in which hardworking taxpayers are burdened in order to provide projects of little public value, but of great value to politicians and special interests.

CONCLUSION

Frederick City leaders have long wanted a major downtown hotel and conference center facility to reinvigorate the city's promising but incomplete urban core revival. There does appear to be sufficient market demand for some lodging and meeting/banquet space in the downtown, but private entities have not provided it because of steep regulatory barriers, along with other obstacles.

Instead of reforming those regulatory barriers, which would encourage broader economic growth, city leaders are fixated on creating a single major, upscale hotel and conference center, funded in part by state and local taxpayers. The problem with these facilities is they usually do not produce the net economic benefits that advocates claim, and they often fail to generate the revenue those advocates expect, which results in continuing need for public subsidies and, oftentimes, a financially strapped and disappointing facility.

Frederick leaders would better serve the public by making private investment in the city's urban core more inviting, instead of forcing state and local taxpayers to share in a dubious and risky investment.

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5. Crossroads Consulting Services, "Report for Maryland Stadium Authority," July 2012, p. 33.
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7. John L. Crompton, "Economic Impact Studies: Instruments for Political Shenanigans?" *Journal of Travel Research* 45: 67–82 (2006), http://www.schoolchoiceworks.org/archives/2011/Crompton-EconomicImpactStudyShenanigans.pdf