San Marcos Municipal Events Center
A Capital Budgeting Case

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Overview

In January the city council for San Marcos, Texas announced the building of a new public-private activity center. Largely modeled after an existing comparable center (i.e., Cedar Park Events Center), the project will consist of a 7,000 seat multi-purpose event center on city owned property on the northern outskirts of San Marcos city limits.

The projected cost of the new facility is $72 million. It will be home to affordably priced entertainment (e.g., concerts, live entertainment), the San Marcos Toros (formerly the Austin Toros) NBADL basketball team, shopping and restaurants. Citizens and visitors will be able to eat, shop, work and play in one compact entertainment district.

The city and a private ownership group Jordan Sports, Ltd. (JSL) are close to reaching a ten year agreement which calls for capital investment by both parties, revenue sharing on all events, and sharing of capital repair and improvement. Jordan Sports, Ltd. is a privately-owned and managed C corporation. JSL has hired you as a consultant to analyze the potential social and financial implications of this project. Use the following information to consider the factors that might impact JSL and the San Marcos community’s agreement and the funding options for the facility.

Components

The San Marcos Event Center Complex will include two inter-related components. Both of these components are discussed below. The San Marcos community currently does not have a facility that is equipped to house a professional team. As a result, the event center with surrounding development is needed, and superior to any other options within a 40 mile radius.

The Center: 185,000 square foot multi-purpose indoor event center with 6,800 seats, 24 luxury suites, a center-hung scoreboard, banquet space, concessions, a state of the art parquet floor for premier basketball events, and 3,000 parking spaces immediately adjacent to the building.

The Surrounding area: An 18 acre mixed-use development with approximately 98,000 square feet of retail (shops, restaurants) and approximately 85,000 square feet of commercial (office space). Together, the event center and mixed-use development will create a pedestrian friendly entertainment destination in the reaches of San Marcos, New Braunfels, Austin, and surrounding Texas Communities. central Texas communities.

Socio-Political Issues

The project, while well intentioned, has been met with some resistance from the city and a vocal group of taxpayers. There are two main reasons for the resistance. First, the city has been hit extremely hard by the recent economic
recession. In the past three years, it has cut school funding, police funding, and street maintenance funding by over 25%. These were significant cuts for which the effects are just now being felt strongly. The second reason for resistance is that the facility is being built on a site that was originally slated for a public-private venture for affordable housing. There is an overwhelming need for such housing in San Marcos, where 40% of the city residents live at or below the median income level for the state of Texas. The public-private venture for the housing development had stalled when the city failed to meet its side of the financing. Thus, many residents feel that if the city does not have money for a housing development, it should not have money for a multi-events center. However, other residents counter-argue that the housing development only costs money, while the events center will make money for the city. Some residents refute this argument though, saying that claims of the event center being an economic driver for the city are false, as no feasibility study has been conducted and any assertions in the report would likely have been exaggerated anyway.

**Sales, Operating Costs, and Financing Options**

The city has formed a capital revenue and budgeting task to provide guidance on the project. The force included members of the city accounting department, several city council members as well as finance officers from JSL. This task force has created a sales and operating costs projection and three financing options for the new facility.

Sales are expected to be $18 million in year, with 15% growth in year two, and 10% growth each year for years 3, 4 & 5, then 5% growth each year for years 6-10. The revenue sources for the sales forecast are projected from tickets sales, parking, concessions, sponsorships, and potential TV rights. Operating costs (not including loan repayments) are expected to be 50% of. The tax rate for the venture is 25%.

**Financing Options  Option 1** - Option 1 utilizes 100% debt. The JSL group would take out a private loan in the amount of $35 million (or 48.6% of the total cost) at 6% interest. The city would back the remaining $37 million (that is, 51.4% of the total cost) by issuing bonds at 3.75% interest. This would be partially backed with general obligation bonds from San Marcos residents (which still require voter approval), and partially with revenue from the facility itself. A city can issue a general obligation bond through the bond market. Typically, a general city-issued general obligation bond is supported by an increase in citizens’ property taxes. This is why issuing a general obligation bond requires voter approval. Also, because the bond is backed by property taxes, the city is often able to receive favorable interest rates for the on the bond. This is one benefit JSL has in partnering with the city of San Marcos (for more on the municipal bond process, see Howard & Crompton, 2004). The annual debt payment (10 years @ 6%) for the $35 million is $4,662,861.08. The annual debt payment on the bonds (interest payments + sinking fund principal obligations for 10 years @ 3.75%) is $4,442,719.20.

**Option 2** - Option 2 utilizes 60% city-backed debt at 4.25% interest (i.e., $43.2 million). This would be paid back through a visitor tax increase on hotels and rental cars, as well as revenue from the facility itself. This tax increase does not require voter approval. The remaining 40% would be offered to preferred limited stockholders. This preferred stock would be offered at $45/share. The dividend expected would be $5 per share and the flotation cost is an inexpensive $1.50 per share. The annual debt payment on this form of financing ($43.2 million for 10 years @ 4.25% interest) is $5,310,361.73.

**Option 3** - Option 3 utilizes a mix of private loans and limited private stock ownership of the facility. In this option, JSL owns 25% of the facility through a limited private stock offering to its internal partners. This would be offered at $43/share, with a $3 dividend and $2 flotation cost. Then, JSL finances an additional 30% through private bank loans (so that its total controlling share is 55%). These loans, totaling $21,600,000, are issued at 6%. The final 45% of the facility will be offered as a limited private sale of common stock to the residents of San Marcos, then surrounding communities. This stock will sell for $20/share with a $2 dividend, $2 flotation cost, and 1.5% growth rate. The annual debt payment on this form of financing (interest + principal for 10 years @ 6%) is $2,877,651.41.

**Your Task**

After this initial examination of the data, the task force has hired you as a consultant to help them make their final analysis and recommendations on the project. Your job is to utilize the revenue and cost to calculate the cash flows from the facility, calculate the WACC of the three project options, and then compute the returns (using NPV and IRR).