Construction is set to begin this coming spring on a hotel near Milwaukee's Mitchell International Airport after government officials in the area spent five years struggling to get a private developer interested in the project.

What tipped the balance? Officials in the small Milwaukee suburb of Oak Creek, Wis., came up with a $2.75 million tax break for the developer, Salita Development LLC.

"We don't believe [the hotel] could be done or would be built without the city's assistance," Oak Creek administrator Gerald Peterson said of the 107-room Four Points by Sheraton hotel project.

Facing a weak economy, cities and local governments have become increasingly inclined to give tax breaks or other incentives like land donations or city-issued bonds to developers who can't raise enough money from conventional sources. Hotels are particularly attractive to local governments because they generate construction activity and numerous unskilled jobs once the hotels open, especially if they draw meetings and conventions.

Still, these hotels don't always perform well and they often generate criticism. For example, Greg Marcus, chief executive of Milwaukee-based Marcus Corp., is concerned that the new airport hotel and other such subsidized projects around the country will drain business from his 20 hotels, including his three in Milwaukee. The city's hotel market faces a 24% increase in its room count due to projects expected to complete construction over the next three years, according to Robert W. Baird & Co.

Mr. Marcus also points out that subsidized hotels carry less debt and thus can undercut their competitors' nightly rates. "When you build something for reasons other than supply and demand, you create imbalances in the system," he said. "That's why our government needs to be so careful with what they do" in subsidizing hotel development.

Mr. Peterson, Oak Creek's administrator, countered that the city commissioned studies that found the market had enough demand for hotel rooms to support the Four Points by Sheraton. In addition, the city covets the taxes that the hotel eventually will generate, given that the city's overall tax revenue has declined 2.7% this year from the 2009 amount.
During the boom, lenders typically agreed to finance up to 80% of a given project's cost. Since the recession, that ceiling has dropped to 60%, leaving developers searching for other capital sources to help fill the resulting gap. To do so, many developers are seeking tax breaks, public bond issues or land contributions from municipalities. In some cases, cities have financed hotels with municipal bonds and essentially owned the properties.

"These things are largely uneconomic without significant public incentive," said Marty Collins, chief executive of hotel developer Gatehouse Capital Corp., which currently is bidding to build subsidized hotels in three states.

Organizers of the Public Private Partnership Conference, which is planning a February meeting in Dallas on publicly subsidized projects, say 55 U.S. cities are either planning or developing hotels with public assistance, including in big cities like Chicago and San Francisco and in places as small as Enid, Okla. Roughly 70% of those projects are aimed at drawing more meetings to town, said Eric Iravani, the conference's executive director.

To be sure, hotel subsidies aren't a new phenomenon. In the mid-1970s, developer Donald Trump persuaded cash-strapped New York City to grant him a 40-year tax break to convert the derelict Commodore hotel on 42nd Street into the Grand Hyatt. "The funny thing is that the city's desperate circumstances became my biggest weapon," Mr. Trump wrote in his 1987 book, "Trump: The Art of the Deal," noting that New York direly needed the jobs and visitors that his project would create.

Some subsidized hotels fare well. One example is the 1,000-room Hyatt Regency Denver at the Colorado Convention Center, built in 2005 with $356 million in municipal bonds. Since 2006, the hotel has paid $52.9 million in taxes to Denver and contributed $2.1 million in excess profits to the city's general fund.

Others have struggled. The Renaissance St. Louis Grand Hotel & Suites, financed with $266 million in industrial revenue bonds, city loans and tax credits, was foreclosed upon in 2009 by its bondholders after it fell short of its financial projections and missed its debt payments. The hotel still is making payments in foreclosure on a $50 million Housing and Urban Development loan arranged by the city, but an additional $30.6 million in city loans was wiped out.

The Sheraton Myrtle Beach Convention Center Hotel in South Carolina, built in 2003 with $64 million of public bonds, quickly ran into trouble covering its debt payments. Myrtle Beach officials addressed the issue by requiring other businesses to help support the hotel. The hotel's debt was refinanced in 2004 so that much of its payments are covered by a 1% citywide tax on hotels, restaurants and entertainment venues.

In Owensboro, Ky., a city of 57,000, a 150-room Hampton Inn & Suites and a 119-room Holiday Inn are slated for construction next to the city's new conference center. Each project will seek to recoup up to 25% of its total cost over the next 10 years in rebates of Kentucky's sales tax through the state's Tourism Development Act.

That could amount to $5 million in rebates for the Hampton Inn project, which developer Malcolm Bryant estimates will cost $20 million to construct. His company started construction on the hotel in April and anticipates finishing it in late 2013. Mr. Bryant also struck a deal with Owensboro in which the hotel isn’t required to pay city property taxes in any year in its first 10 that it averages less than 65% occupancy.

"There wouldn't have been any way that someone would speculate on building this size and quality of hotel without the public support," he said.

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