

DATE ISSUED: October 8, 2001

REPORT NO. 01-217

ATTENTION: Rules, Finance & Intergovernmental Relations Committee
Agenda of October 10, 2001

SUBJECT: Transient Occupancy Tax Rate

SUMMARY

Issue - Should the City Council approve the International Association of Firefighters Local 145 proposal to pursue a March 2002 ballot measure that would effectively increase the City of San Diego's Transient Occupancy Tax (TOT) rate by approximately 3.0% resulting in a rate of approximately 13.5% beginning in Fiscal Year 2003, with the rate adjusted every two years thereafter to maintain the average of the rates of 10 major western cities?

Manager's Recommendation - 1) Pursue a March 2002 ballot measure that would maintain a majority vote requirement for future TOT increases consistent with Proposition 218, and 2) If a change to the TOT rate is to be considered, then direct the City Manager to work with groups affected by the proposed TOT rate change, including the Hotel Motel Association, San Diego Convention & Visitors Bureau, San Diego Convention Center Corporation, arts organizations and other stakeholders, and then return to the Rules, Finance, & Intergovernmental Relations Committee for consideration of a proposal regarding any change to the TOT rate.

Other Recommendations - None.

Fiscal Impact - None.

BACKGROUND

During the Rules, Finance & Intergovernmental Relations Committee meeting of September 26, 2001, the City Manager was directed to provide a report at the Committee's October 10, 2001

meeting regarding a proposal by the International Association of Firefighters Local 145 to increase the City of San Diego's TOT rate for Fiscal Year 2003 and beyond.

TOT revenues are allocated to programs which advance the City's economic health by promoting the City of San Diego as a visitor destination in the national and international marketplace; supporting programs that increase hotel occupancy and attract industry, resulting in the generation of TOT and other revenue; developing, enhancing, and maintaining visitor-related facilities; and supporting the City's cultural amenities and natural attractions. Additionally, TOT supports public safety, park and recreation, library, street and other core public services, which benefit San Diego residents and visitors alike.

Currently, the City's TOT rate is 10.5%. The last increase to the TOT rate, which took effect on August 1, 1994, resulted in a rate increase from 9% to 10.5%. This increase was approved by a vote of the City Council. As stipulated in Ordinance No. O-18078 N.S., this additional 1.5% tax has been allocated for general government purposes as the City Council so designates in accordance with the annual Appropriation Ordinance. Municipal Code Chapter 3/Article 5/Division 1 and Council Policy 100-03 were modified in conjunction with the adoption of the Ordinance.

As stated in Municipal Code Sections 35.0128 – 35.0133 and outlined in Council Policy, the 10.5% (or 10 ½ cents) is to be used as follows:

- 1) Four cents must be used solely for the purpose of promoting the City.
- 2) One cent can be used for any purpose the City Council may direct.
- 3) Five and one-half cents is deposited in the General Fund for general government purposes as the City Council may provide in accordance with the Charter of the City of San Diego and the City Council's appropriation ordinance.

Council Policy 100-03 provides limitations on future TOT rate increases levied by the City of San Diego by limiting future TOT increases to a rate no greater than the average rate, excluding the highest and lowest rate cities, of the following 15 major cities: Atlanta, Boston, Chicago, Denver, Honolulu, Houston, Las Vegas, Los Angeles, Miami Beach, New Orleans, New York, San Francisco, Santa Fe, Seattle, and Washington D.C. This currently translates into a TOT rate cap of 13.2%. Council Policy 100-03 also stipulates that the City Council limit any tax increases if hotel occupancy rates in the City of San Diego are less than 70% for two consecutive years.

DISCUSSION

International Association of Firefighters Local 145 Proposal

The proposal presented by the International Association of Firefighters Local 145 involves setting the City of San Diego's TOT rate at the average rate of 10 major western cities, which are considered to be San Diego's primary competitors for conventions and tourism in general. The cities and the rates utilized in their proposal follow:

Houston	17%
San Antonio	16%
Seattle	16%
Anaheim	15%
Los Angeles	14%
San Francisco	14%
Denver	14%
Phoenix	11.5%
San Jose	10%
Las Vegas	9%

Were such a proposal to be approved, the result would be an approximate 3.0% increase in the TOT rate resulting in a rate of approximately 13.5% for San Diego beginning in Fiscal Year 2003, with the rate adjusted every two years thereafter to maintain the average of these 10 cities' rates. The impact of such a rate increase at current budgeted levels of \$118.2 million would be an approximate \$33.8 million revenue increase.

City Manager's Recommendation

As previously stated, a component of the City Manager's recommendation is that the City pursue a March 2002 ballot measure that would maintain a majority vote requirement for future general government purpose TOT increases consistent with Proposition 218. In addition, at the direction of the Rules, Finance & Intergovernmental Relations Committee, the City Manager will work with groups affected by the proposed TOT rate change, including the Hotel Motel Association, San Diego Convention & Visitors Bureau, San Diego Convention Center Corporation, arts organizations and other stakeholders, to develop proposals for TOT rate changes for City Council consideration. If the Rules, Finance & Intergovernmental Relations Committee chooses to pursue a TOT rate increase for the March 2002 ballot, then the City Manager would need to present proposals before the Committee no later than its November 7, 2001 meeting and go before the City Council no later than its November 19, 2001 meeting. This timeline is in accordance with the City Clerk's administrative guidelines, which requires the City Council to adopt ballot proposals by November 20, 2001 to be considered on the March 2002 ballot.

General Discussion

Although the last TOT rate increase was approved solely by a vote of the City Council, due to changes in state law, any proposal to raise the TOT rate requires a vote of the electorate. The proposal made by the International Association of Firefighters Local 145, which establishes a formula for an automatic tax adjustment, would also require voter approval since it amends the City Charter. The next opportunity for a ballot measure is March 2002. This matter is time sensitive in nature as efforts toward meeting the requirements and deadlines related to a March 2002 ballot measure must commence shortly.

Proposition 218, approved by California voters in November 1996, resulted in the addition of Article XIII C to the California Constitution. This article outlines the limitations placed on local government taxation. It defines all taxes as either general taxes or special taxes and stipulates that increases to a general tax be submitted to the electorate and approved by a majority vote and increases to a special tax be submitted to the electorate and approved by a two-thirds vote. Currently, any increase in general taxes, which includes TOT, requires a majority vote to pass if the revenue generated by such an increase is not earmarked for a specific purpose as stipulated in Proposition 218. ■

A measure already approved for the March 2002 ballot for consideration by the voters of San Diego would make it more difficult for the City of San Diego to raise general taxes by requiring two-thirds voter approval of such tax increases, including TOT. Should a proposal for a TOT rate increase not be presented to San Diego voters in March 2002 and should the abovementioned ballot measure be approved by a majority vote, this will change the voter approval requirement for any future TOT rate increase from a majority vote to a two-thirds vote.

An increase in the TOT rate would provide the City of San Diego with an opportunity to address increasing operational costs and competing priorities within General Fund programs. General deferred maintenance and infrastructure improvements remain largely unfunded and will only grow with the City's existing tax base. Meanwhile, TOT revenue will continue to provide financial support to those projects, such as the Balboa Park/Mission Bay Park Improvements and the Trolley Extension, where financial commitments of the City are in place through Special Promotional Programs. Also, support for the City's cultural amenities and natural attractions and other visitor-related facilities as well as public safety enhancements will remain priorities. As implied, proceeds attributed to any TOT rate increase will be deposited in the General Fund for core public services as determined by the Mayor and City Council through the annual budget process.

An important factor to consider in a review of any changes to the TOT rate will be maintaining San Diego's competitive edge in this industry. Since TOT revenues are generally tied to the demand for rooms generated by the City's economy, rather than the tax rate, this may not be a significant issue. Also, it is noteworthy that the last increase in the TOT rate did not adversely impact demand for rooms, although room rates were lower and the rate increase was only 1.5%. This is consistent with Standard & Poor's findings as reproduced in March 2001 from Standard & Poor's RatingsDirect, that "the only apparent case where high hotel tax rates actually decreased hotel bookings and tax revenues was a brief period in New York City during the 1990's".

According to a study prepared by the American Economic Group, Inc. in 1998, titled "Impact of Room Tax Increases on the Lodging Industry", the national average of "bed taxes" was about 11.7% of the price of the room in 1997, with a range of 4% in Billings, Montana, to 17% in Houston, Texas. The mode, or most common tax rate, was between 12% and 13%. This study suggests that hotel rooms are similar to most other goods and services in that, at higher room rates, fewer room nights are sold, other things being equal. The study also suggests that, although increases in the TOT rate may increase TOT revenues, there may be decreases in

overnight visitor spending which may result in the reduction of jobs, sales, and other tax collections.

Yet, the San Diego Regional Chamber of Commerce recently published Transient Occupancy Tax Trends indicating that San Diego has one of the lowest TOT rates for a city of its size, economy and prestige. There is little evidence that the last increase in the City's TOT rate in 1994 had any impact on hotel occupancy or visitor activity. In fact, during the following year, the number of overnight visitors to San Diego increased to a record high, total visitor spending rose 4.4 percent, and the hotel occupancy rate actually increased, while absorbing a 6.2 percent increase in the average daily room rate. The City's slight increase in the TOT rate resulted in a 24 percent jump in revenues during 1995 setting a record \$57.2 million. The Chamber indicates that as long as the TOT rate remains relatively lower than similarly sized communities and our main competitors for convention and hotel business, San Diego's visitor business will remain competitive. Also, according to representatives from various Convention and Visitor Bureaus, it can be gathered that location, facilities, and current economical conditions have greater impacts on tourism and convention attraction rather than minor increases in the TOT. However, minor TOT increases have proven to stimulate tremendous growth in TOT revenue.

Conclusion

It has been seven years since an increase in the TOT rate was approved. In past years, increases in the TOT rate were approved more frequently. Since the last TOT rate increase in 1994, the City of San Diego partnered with the San Diego Convention Center Corporation to complete the expansion of the Convention Center, which has more than doubled the facility's size. This and other endeavors have promoted the City's economic development and increased its competitiveness in tourism, its third largest industry.

ALTERNATIVES

Alternative A – Phase in 3.0% increase by 1.0% each fiscal year beginning in Fiscal Year 2003, and possibly even cap future growth in the rate to no greater than 1.0% per fiscal year.

Alternative B - Subject to a majority only vote, give the City Council the authority to consider an increase to the TOT rate up to the average of the ten aforementioned cities, allowing the City Council at least once every two years to take several factors into consideration when contemplating a rate adjustment. These factors may include occupancy rates, room rates, and the state of the economy, working with the key stakeholders including the visitors industry to reach a reasonable outcome. (As currently stipulated in Council Policy 100-03, any tax increases would not be considered if hotel occupancy rates in the City of San Diego are less than 70% for two consecutive years.)

Alternative C - A combination of the original proposal and Alternatives A and B, or not pursue any TOT rate change at this time.

Respectfully submitted,

Lisa Irvine
Financial Management Director

Approved: Michael T. Uberuaga
City Manager

IRVINE/TAS

Note: The attachment is not available in electronic format. A copy is available for review in the Office of the City Clerk.

Attachment: Council Policy 100-03