

DATE ISSUED: October 9, 2003 **REPORT NO.** 03-202

ATTENTION: Honorable Mayor and City Council
Docket of October 13, 2003

SUBJECT: Financial Analysis of Proposed Transient Occupancy Tax Ballot Measure

REFERENCE: Transient Occupancy Tax Ballot Measure, September 26, 2003

SUMMARY

Issue – Shall the City Council accept the City Manager’s financial analysis of the proposed Transient Occupancy Tax (TOT) ballot measure as amended by the Committee on Rules, Finance and Intergovernmental Relations on October 1, 2003?

Manager’s Recommendation– Accept the financial analysis of the proposed TOT ballot measure contained herein. Additionally, should the City Council vote to pursue the proposed TOT increase, then the ballot proposal should be revised to incorporate the recommended changes beginning on page 10 of this report.

Other Recommendations– None.

Fiscal Impact – When applied to Fiscal Year 2004 budgeted TOT projections, the proposed two and one-half cent increase in the TOT rate would result in approximately \$26.4 million in additional TOT revenues, an increase of approximately 24%. However, due to the specific designation of \$68.5 million (50%) of total TOT allocations proposed by the ballot measure, as well as other non-discretionary obligations not addressed by the ballot measure, the General Fund’s discretionary TOT revenues would decrease by approximately \$250,000. This TOT ballot measure will not address the General Fund’s underfunding issues.

The manner in which the proposed ballot measure allocates and earmarks both new and existing TOT revenues is inconsistent with the City's established budget review and development process as well as the City's established budget principles and practices. This method of allocating funding does not address the General Fund's lack of sufficient ongoing discretionary revenues to meet emerging needs and obligations. Despite the substantial increase in TOT revenue this ballot measure would generate, it still leaves the General Fund in substantially the same condition as it is currently.

The proposed ballot measure calls for irrevocable allocations to Tourism. This abrogates the Mayor and City Council's authority and is inconsistent with current budget principles.

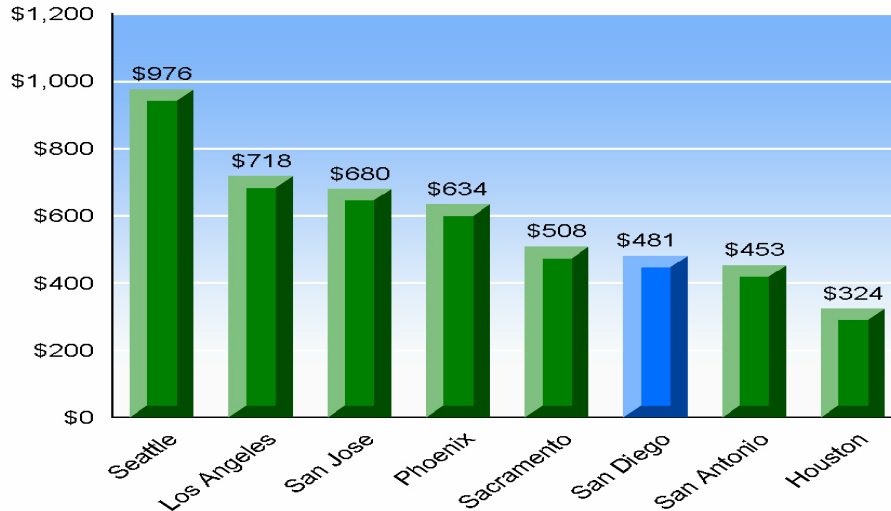
The Maintenance of Effort (MOE) requirements for specified categories of Fire-Rescue and Police equipment and maintenance would earmark a minimum of \$6 million of non-TOT discretionary General Fund revenue.

BACKGROUND

Since Fiscal Year 1992, the State of California has diverted more than \$329 million in property tax increments from the City of San Diego to the Education Augmentation Relief Fund (ERAF), as well as withholding an additional \$20.1 million of other funding (vehicle license fee backfill, grants, redevelopment and right-of-way maintenance funds) in Fiscal Year 2004 alone. Additionally, in recent years, the cost of providing City services has outpaced General Fund revenue growth. Inflationary increases, the provision of competitive compensation to City staff, and the constant struggle to keep abreast of deferred maintenance of the City's infrastructure have had the effect of eroding revenues that are available for discretionary allocation to emerging needs and priorities.

Relative to peer cities, San Diego has historically had a comparatively low tax-related revenue base. San Diego does not charge for residential refuse collection and has never implemented a Utility User Tax as many California cities have done. Furthermore, San Diego has relatively low Transient Occupancy Tax and Business License Fees. The following graph demonstrates San Diego's low tax base by comparing per-capita tax revenue of several major cities.

COMPARISON OF WESTERN CITIES
FY 1999-2000 General Fund Budgeted Revenues/Expenditures Per Capita



The City of San Diego’s philosophy has been to live within its means. The City has taken efforts to reduce expenditures and provide services effectively and efficiently through Performance Based Budgeting, the Organization Effectiveness and Optimization programs, and the Select Committee on Government Efficiency and Fiscal Reform. Despite these efforts, and because of the City’s low revenue base, additional ongoing discretionary revenues are required to maintain the current level of basic City services. As discussed with the Committee on Rules, Finance and Intergovernmental Relations (Rules Committee) on April 2, 2003, a TOT increase is one of several potential sources of new revenue being explored by the City.

The City of San Diego’s General Fund is comprised primarily of five major revenue sources: property tax, sales tax, transient occupancy tax (TOT), motor vehicle license fees, and franchise fees. In Fiscal Year 2004 these sources account for nearly 69 percent of the \$743 million in General Fund revenues. The largest General Fund revenue source is property tax, projected at \$199.8 million in Fiscal Year 2004, followed by sales tax, budgeted at \$127.9 million for the General Fund (including safety sales tax). Together, property, sales, and safety sales tax account for \$327.7 million, or 44 percent, of the General Fund revenue base. In contrast, allocations for the San Diego Fire-Rescue and Police Departments make up over 53 percent of all General Fund allocations. Even if the two largest General Fund revenue sources were dedicated solely to funding Police and Fire-Rescue, there would still be inadequate funding for the two departments.

Attachment 1 shows the combined revenue receipts for property, sales, and safety sales tax for the past 15 years, juxtaposed against public safety expenditures for the same period. This effectively illustrates the City’s commitment to public safety over this time period, as well as the failure of the largest revenue sources at the General Fund’s disposal to keep pace with public safety allocations.

On October 1, 2003, the Lodging Industry Association (LIA), in cooperation with the San Diego City Firefighters Local 145 (Local 145) and the San Diego Police Officers Association (POA), submitted a proposed TOT ballot measure, dated September 26, 2003, for consideration by the Rules Committee. The ballot measure proposes to increase the TOT rate from ten and one-half cents to thirteen cents, and specifically designates TOT revenues as shown in Table 1 below.

It is important to clarify that the ballot measure discussed at the Rules Committee on October 1, 2003 is not the same measure for which LIA and Local 145 are currently gathering signatures to qualify for the March 2004 ballot. That proposal, dated July 30, 2003, is significantly different from the one presented to the Rules Committee and there are questions about the legality of its provisions, as discussed in the City Attorney’s memorandum dated August 21, 2003 (Attachment 2).

Table 1. Modified LIA/Local 145/POA TOT Ballot Measure (09/26/2003)

Categories	Description	Allocation
Fire	San Diego Fire-Rescue Department	1.00 cents
Police	San Diego Police Department	1.00 cents
Infrastructure		0.50 cents
	Neighborhood Road Improvements	<i>0.17 cents</i>
	Mission Bay Improvements	<i>0.14 cents</i>
	Balboa Park Improvements	<i>0.14 cents</i>
	Coastal Improvements	<i>0.05 cents</i>
Tourism		2.50 cents
	San Diego Convention and Visitors Bureau	<i>1.37 cents</i>
	San Diego Convention Center	<i>0.55 cents</i>
	San Diego North Convention and Visitors Bureau	<i>0.06 cents</i>
	Other Promotional Programs	<i>0.52 cents</i>
Arts	Commission for Arts & Culture	1.00 cents
Library	Library Debt Service	0.50 cents
General Fund	General Fund Discretionary	6.50 cents

During the Rules Committee discussion on October 1, 2003, Councilmember Peters made a motion to refer the modified LIA/Local 145/POA TOT ballot measure to the City Manager and City Attorney for financial and legal analysis, respectively. The City Attorney has prepared a separate report on the legal analysis.

The motion, approved 3-1 by the Rules Committee, also proposed the following amendments to the ballot measure as submitted:

- Adjust the allocation to Fire-Rescue from one cent to three-quarters of a cent
- Reallocate the remaining one-quarter of a cent as follows: up to one-quarter of a cent to the preparation of a Parks Master Plan for the first three years, with the remainder distributed equally between Mission Bay, Balboa Park, and Coastal Improvements
- Remove the 36-month requirement for the completion of the Coastal Infrastructure Master Plan

- Allow the Tourism Promotion Review Board to re-evaluate and adjust the funding minimums outlined for tourism and promotional activities every five years on a two-thirds vote of the City Council
- Ensure that a successful challenge to the ordinance would result in the TOT rate reverting to its current state
- Ensure that the ballot measure is subject to existing charter provisions allowing declaration of financial emergency
- Clarify that maintenance of effort and growth requirement to match General Fund growth for Police and Fire-Rescue applies only to the specified equipment and infrastructure categories listed in the ballot measure
- Revise the designation to Library Debt Service such that it is allocated to the Library as a whole

With the above proposed revisions to the ballot measure by the Rules Committee, the TOT revenues would be allocated as follows:

Table 2. Rules Committee Revised TOT Draft Ballot Measure (10/1/2003)

Categories	Description	Allocation
Fire	San Diego Fire-Rescue Department	0.75 cents
Police	San Diego Police Department	1.00 cents
Infrastructure*		0.75 cents
	Parks Master Plan*	<i>0.25 cents</i>
	Neighborhood Road Improvements	<i>0.17 cents</i>
	Mission Bay Improvements	<i>0.14 cents</i>
	Balboa Park Improvements	<i>0.14 cents</i>
	Coastal Improvements	<i>0.05 cents</i>
Tourism		2.50 cents
	San Diego Convention and Visitors Bureau	<i>1.37 cents</i>
	San Diego Convention Center	<i>0.55 cents</i>
	San Diego North Convention and Visitors Bureau	<i>0.06 cents</i>
	Other Promotional Programs	<i>0.52 cents</i>
Arts	Commission for Arts & Culture	1.00 cents
Library	Library Debt Service	0.50 cents
General Fund	General Fund Discretionary	6.50 cents

*Up to one-quarter cent of this allocation would be dedicated to the Parks Master Plan for the first three years, with the remainder distributed equally among Mission Bay, Balboa Park, and Coastal Improvements. After the third year, Parks Master Plan will not receive an allocation.

If approved by a majority of the City Council, this measure would be placed on the General Election ballot for March 2004 and the requirements would take effect on July 1, 2004 (Fiscal Year 2005) if approved by two-thirds of the voters.

DISCUSSION

Currently, the allocation of Transient Occupancy Tax is at the discretion of the Mayor and City Council, with guidelines provided by Council Policy 100-03 (Attachment 3). This policy limits any TOT increase to the average TOT rate of 15 designated cities. Currently, that average is 13.16 percent

or 2.64 percent higher than the City of San Diego's current TOT and 0.16 percent higher than the proposed rate. The Council Policy also stipulates that, of the current ten and one-half cent TOT, four cents should be applied toward promotion of the City of San Diego as a tourist destination, five and one-half cents should be applied toward general government purposes, with the remaining one cent to be allocated for any purpose that the Mayor and City Council may direct.

While these designations provide some limitations as to the current allocation of TOT, there remains some discretionary flexibility within the defined categories. Further, since these allocations are governed by council policy rather than by ordinance put in place by the voters, the Mayor and City Council have the authority to modify the existing policy should it become evident that the allocations no longer meet the needs of the City.

Council Policy 100-03 would have to be rescinded if this ballot measure is approved by two-thirds of the voters in March, since the ballot measure would earmark 50% of all TOT revenues for specific programs or activities. The following table depicts the change in TOT allocations that would occur if the ballot measure were passed, using Fiscal Year 2004 TOT projections and allocations:

Table 3. Fiscal Year 2004 TOT Allocation: Current vs. Proposed

Categories	Fiscal Year 2004 Budget	Proposed Allocation	Change in Allocation
Fire	\$0	\$7,907,143	\$7,907,143
Police	\$7,689,632	\$10,542,857	\$2,853,225
Infrastructure	\$0	\$7,907,143	\$7,907,143
Parks Master Plan	\$0	\$2,635,714	\$2,635,714
Neighborhood Road Improvements	\$0	\$1,792,286	\$1,792,286
Mission Bay Improvements	\$0	\$1,476,000	\$1,476,000
Balboa Park Improvements	\$0	\$1,476,000	\$1,476,000
Coastal Improvements	\$0	\$527,143	\$527,143
Tourism	\$19,317,808	\$26,357,143	\$7,039,335
San Diego Convention and Visitors Bureau	\$12,540,299	\$14,443,714	\$1,903,415
San Diego Convention Center	\$4,197,880	\$5,798,571	\$1,600,691
San Diego North Convention and Visitors Bureau	\$470,250	\$632,571	\$162,321
Other Promotional Programs	\$2,109,378	\$5,482,286	\$3,372,908
Arts	\$9,641,475	\$10,542,857	\$901,382
Library	\$5,342,152	\$5,271,429	(\$70,723)
General Fund	\$68,708,933	\$68,528,572	(\$180,361)
General Fund Programs	\$37,627,677	\$37,447,316	(\$180,361)
Promotion	\$2,128,763	\$2,128,763	\$0
Debt Service	\$28,952,493	\$28,952,493	\$0
TOTAL	\$110,700,000	\$137,057,144	\$26,357,144

As shown above, the new revenues of approximately \$26.4 million, or 2.5 cents, would be primarily allocated as follows:

- \$7.0 million to tourism organizations
- \$7.9 million to the Fire-Rescue Department
- \$7.9 million to infrastructure

- \$2.8 million to the Police Department
- \$0.9 million to arts organizations

For the purposes of this illustration, Tourism is defined by the modified LIA/Local 145/POA TOT ballot measure to include the following organizations and events: ConVis, North ConVis, Convention Center Operations, Holiday Bowl, Gold Coast Classic, Accessible San Diego, San Diego International Sports Council, San Diego Film Commission and the Major Events Revolving Fund. The General Fund category is funding allocated for General Fund purposes such as public safety, parks and libraries, and debt service. Debt service includes the City's committed debt service payments for projects such as San Diego Convention Center, Ballpark and Redevelopment Project, Balboa Park/Mission Bay Park Improvements, and Old Town and Bayside Trolley. A sub-category known as Promotion, which will have to be funded from General Fund discretionary revenue, has been developed to account for the many economic development organizations and programs currently funded by Special Promotional Programs that are not included by the proposal under Tourism.

If the modified LIA/Local 145/POA TOT ballot measure is approved by voters, the General Fund would suffer a loss of actual revenues of approximately \$180,000. Additionally, the General Fund would be required to cover the decrease of TOT revenues allocated to the Library with either discretionary TOT or other revenue sources, to be consistent with the Library System Financing Plan. In effect, there would be a loss to the General Fund of approximately \$250,000, which would impact departments such as Police, Fire-Rescue, Library and Park and Recreation; the major recipients of General Fund monies.

Maintenance of Effort

The Rules Committee's revised TOT draft ballot measure requires Maintenance of Effort (MOE) funding. This specifies that revenues from the increased TOT shall be used in addition to and shall supplement the current General Fund allocations for equipment, communications systems, apparatus, fleet vehicles, deferred maintenance and facilities. The current funding is defined as the 2003 actual expenditures for these categories in the Fire-Rescue and Police departments, increased annually by an amount equivalent to the annual percentage growth in the General Fund. It is unclear whether the 2003 time frame is a fiscal year or a calendar year.

The draft ballot measure also contains requirements that preclude the use of new TOT revenues to fund existing budgeted personnel for the San Diego Fire-Rescue and Police Departments. Once specific funding requirements are met for new communication systems, apparatus, fleet vehicles, facilities and for existing deferred maintenance, then only personnel expenses associated with new facilities for Fire-Rescue or new officers for Police may be funded through new TOT revenue. Moreover, the new personnel and facilities must directly address the goal of six-minute response times for Fire-Rescue, and the goal of maintaining two police officers per 1,000 residents within the City of San Diego. It is important to note here that, although the goal of a six-minute average response time is a national standard, maintaining two police officers per 1,000 residents has not been shown to measure a city's crime prevention and prosecution services in a meaningful way.

The requirement of an MOE and provisions on how the TOT proceeds may be used removes the Mayor and City Council's discretion in determining funding for both Fire-Rescue and Police for long range planning, and emergencies, and does not allow consideration of prioritized needs of the departments or the General Fund as a whole. This also places an additional burden on the General Fund because increases in ongoing expenses in either Fire-Rescue or Police may not be eligible for funding from increased TOT revenue. In difficult fiscal years such as Fiscal Year 2003 or 2004, this

could cause reductions in other General Fund departments in order to fund ongoing Fire-Rescue and Police operations, even with new increased TOT revenue allocated to them.

By not allowing the discretion of the Mayor and Council in determining funding priorities, the MOE requirements are in conflict with the City Charter as stated in the City Attorney's Legal Analysis, pages 3 and 4.

Fire-Rescue

The Rules Committee's revised TOT draft ballot measure would dedicate three-quarters of a cent, or 30% of new TOT revenues, to a TOT Fire-Rescue Fund. Using Fiscal Year 2004 TOT allocations, this would amount to approximately \$7.9 million, which would be used to pay for eligible appropriations including fire apparatus, communication systems, deferred maintenance, and a needs assessment for the Fire-Rescue Department. In Fiscal Year 2003, the Fire-Rescue Department spent approximately \$4.9 million on the aforementioned categories. This would become the MOE base for General Fund obligations for these specific categories for the Fire-Rescue Department according to the proposed ballot measure.

Police

The TOT Police Fund would receive one-quarter of a cent, or 10% of new TOT revenues under the Rules Committee's revised TOT draft ballot measure. Using Fiscal Year 2004 TOT allocations, this would amount to approximately \$2.6 million to pay for eligible appropriations including police vehicles, communication systems, deferred maintenance, and a needs assessment for the Police Department.

Additionally, the proposal requires that three-quarters of a cent (\$7.9 million) of the existing TOT rate be used to continue funding existing police officer positions and related support in the General Fund.

The ballot measure also establishes maintenance of effort (MOE) levels and growth requirements for specified Police Department allocations (public safety equipment, communications systems, police vehicles, deferred maintenance and facilities). In Fiscal Year 2003, the Police Department spent approximately \$950,000 on these specified allocations which would become the MOE base for General Fund obligations for Police according to the proposed ballot measure.

Tourism

In Fiscal Year 2004, the Mayor and City Council allocated \$19.3 million of TOT budgeted revenues to tourism organizations. As defined by the modified LIA/Local 145/POA ballot measure, this category includes the Holiday Bowl, ConVis, North ConVis, Convention Center Operations, Gold Coast Classic, Accessible San Diego, San Diego International Sports Council, San Diego Film Commission, and the Major Events Revolving Fund.

Under the proposed TOT ballot measure, the allocation to Tourism would increase by approximately \$7.0 million or 36.4% over Fiscal Year 2004 allocations, to \$26.4 million. This allocation would be a guaranteed minimum allocation without the benefit of performance measures or service level enhancement requirements. Therefore, it would be difficult to quantify the measurable return on this investment.

The proposed ballot measure would also establish the Tourism Marketing and Promotion Fund, to receive the Tourism allocation, as well as the City of San Diego Tourism Promotion Review Board, which would prepare the annual budget for the Tourism Marketing and Promotion Fund, allocating 100% of funds held in or due to the Fund. The Board would then submit the budget to the Mayor and City Council for their approval.

Financial Analysis

From a financial perspective, there are several aspects of the proposed TOT ballot measure that should be addressed:

Earmarking of Discretionary Revenues

The City of San Diego currently operates under eight budget principles, recommended by the Blue Ribbon Committee on City of San Diego Finances and approved by the Mayor and City Council. Budget Principle #6 reads as follows:

“Discretionary General Fund revenues should not be earmarked, thereby allowing maximum flexibility in funding decisions on an annual basis.”

The manner in which TOT revenues are obligated under this ballot measure is inconsistent with this budget principle. While the General Fund currently has certain non-negotiable obligations to which some TOT revenues are dedicated, these revenues are not specifically “earmarked” by ordinance, thus allowing the Mayor and City Council a degree of flexibility and discretion in determining how these obligations will be funded. It is important to note that, while the proposed ballot measure earmarks new TOT revenue, it also earmarks existing TOT revenue. The proposed TOT ballot measure substantially reduces the flexibility of the Mayor and City Council to adapt the City’s budget to changing needs.

Under the City of San Diego’s current budget process, all General Fund needs are brought forward on a department-by-department basis, with explanation of the need and detailed description of staffing and non-personnel requirements. The Mayor and City Council then have the ability to assess all General Fund needs, as well as availability of revenues to fund those needs, and make decisions as to criticality and prioritization. They also have the ability to determine where reductions must be taken in circumstances where new needs, priorities and obligations exceed available revenues.

The proposed TOT ballot measure circumvents this process, since certain allocations of General Fund revenues are rendered automatic and non-negotiable. While public safety is and has been the City’s highest priority and currently receives approximately 53% of General Fund dollars, the ballot measure will not solve the underfunding of public safety in the General Fund. It will instead allocate funding to new public safety items that are not prioritized with the other, existing needs of public safety within the General Fund. These allocations also would not be weighed against the other needs of the General Fund to determine their relative criticality.

Attachment 4 shows the breakdown of discretionary and non-discretionary TOT revenue. The top graph shows that under current policy, all 10.5 cents of TOT are allocated at the discretion of the City Council. These allocations are currently governed by Council Policy 100-03, but may be changed at any time by Council Policy. In contrast, the bottom graph shows that under the proposed ballot measure, the City of San Diego would lose discretionary control over 50% of all TOT revenue. This 6.5 cents would be allocated according to the ordinance voted on by the people, and thus could not be

changed by Council Policy. In challenging fiscal years, the reduction in flexibility for revenue solutions could cause significant financial hardship to the City, particularly given the precarious financial position of the State, the proposal to eliminate the Vehicle License Fee without the provision of backfill, and the additional funding required to support the City's Pension System.

The earmarking as proposed by this ballot measure is contrary to the City Charter. See City Attorney's Legal Analysis, page 5.

Recommendation: In order to restore some level of flexibility and discretion on the part of the Mayor and City Council, it is recommended that language similar to the following be incorporated into the proposed ordinance (see City Attorney's Legal Analysis, Attachment 1, Section 35.0135, page 14):

If the City Council determines that anticipated revenues in any fiscal year will be insufficient to maintain existing City services, the City Council may, by a two-thirds vote, temporarily suspend compliance with Section 35.0128 for the upcoming fiscal year.

Maintenance of Effort Requirements

Similar to the earmarking issue, the requirement to maintain specified General Fund Public Safety allocations at the level of Fiscal Year 2003 actual expenditures, as well as to incorporate a growth rate into these allocations consistent with the growth of the General Fund, is inconsistent with the City's existing budget principles and budget deliberation practices. It is not sound fiscal policy to allocate funds in isolation, without considering the application of these funds or the criticality of the need in relation to other General Fund budget priorities. Again, the Mayor and City Council should retain the discretion to review all General Fund requirements and make decisions as to priority, funding level, and funding source. In addition, this ballot measure, through the MOE requirement, earmarks other General Fund revenue as well as TOT revenue, thereby further reducing the City's ability to solve fiscal challenges.

Recommendation: All references to a requirement for Maintenance of Effort allocations should be removed from the proposed TOT ballot measure. The City Attorney states that the MOE requirements "squarely conflict with the City Charter which contains a comprehensive expression of the will of the electorate with respect to how the budgeting and appropriation process must be implemented by the City Council, and which carefully sets forth the separation of powers with respect to these matters." See City Attorney's Legal Analysis, page 4.

Potential Credit Impacts

The City's ability to service outstanding debt and maintain a strong credit rating is directly impacted by the strength and flexibility of its General Fund revenue base. While the overall size of the revenue base relative to annual debt service requirements is a primary measure of financial strength, the credit rating agencies also consider the discretionary nature of the revenue base in arriving at their final credit rating. The benefits associated with a large fast growing revenue base are mitigated to the extent that revenues are earmarked for special purposes. From the rating agencies perspective, the larger the share of revenues that are potentially available to meet debt service needs, the stronger the municipal entity's ability to incur additional debt or service its existing debt.

Historically, City's revenue base and reserves as a ratio of debt service obligations have been considered somewhat lean. The credit rating agencies look for economic growth or revenue enhancements in the form of new taxes, or increased taxes to support continued revenue growth. Since for almost a decade the City has relied almost entirely on economic growth to increase its revenue base, the rating agencies would likely take a favorable view toward the proposed increase in TOT, while taking a less favorable view toward the associated earmarking of 50% of the increase.

Additionally, since the City's current strong credit rating is due in part to its demonstrated capacity to make swift budgetary adjustments in response to unforeseen developments, the earmarking of TOT and other General Fund revenue through the MOE requirement proposed by this ballot measure could cause the credit rating agencies to take a more critical view of the City's financial practices. With the revenue outlook still uncertain in light of the uneven recovery and the State's ongoing fiscal difficulties, any significant earmarking of general purpose revenues would likely be viewed as limiting the City's ability to maintain its high standard of budgetary flexibility.

Recommendation: Implementing the recommendations above in regards to earmarking of funds and eliminating MOE requirements should reduce this concern.

City of San Diego Tourism Promotion Review Board and Tourism Marketing and Promotion Fund

The proposed ballot measure does not indicate the source of the Board's annual projections to be used for the budget development process. It is of concern that the Board could potentially base their budget allocations on revenue projections developed or obtained independent of the City Manager.

Recommendation: Language should be added to Section 26.1704 of the proposed ordinance specifying that the Board's annual budget development be based on TOT projections provided and periodically updated by the City Manager. See City Attorney's Legal Analysis, Attachment 2, page 19.

Secondly, the proposed ballot measure allows for up to one percent of the Tourism Marketing and Promotion Fund to be allocated for administration. Based on Fiscal Year 2004 allocations, this would be approximately \$263,571. This may not be sufficient, depending on how the program is structured. This also may not account for internal audits that are required to ensure compliance with Council Policies and ordinances.

Recommendation: Ensure that administration expenses are allowed on a reimbursable basis for 100% of administration, overhead and audit costs for the Tourism Marketing and Promotion Fund. See City Attorney's Legal Analysis, Attachment 2, pages 21 and 22.

Another area of concern is that the allocations through the Tourism Marketing and Promotion Fund are irrevocable and in perpetuity. The proposal does not provide for reallocation of funds should one of the nine organizations within the Tourism Fund cease to operate or cease to achieve results. The ballot measure allows the allocation to be passed on to successor organizations regardless of the evolving missions, goals or organizational status of these groups over time. Although the proposal allows the Tourism Promotion Review Board to review, audit and evaluate the effectiveness of tourism promotion, the Board does not have the authority to change an organizations' funding allocation based on its findings during these reviews.

Recommendation: Empower the Tourism Promotion Review Board to make funding recommendations for Council review and approval. Do not set minimum funding levels and do not identify specific organizations within the Tourism category.

CONCLUSION

While the proposal to increase TOT revenue (approximately \$26.4 million) would provide additional revenue for some important services, the provisions of earmarking discretionary revenue (approximately \$68.5 million) and including a maintenance of effort are problematic. These provisions would impair the ability of the Mayor and City Council to allocate funding to address the highest priorities if the City revenue base erodes significantly, as currently threatened by the State of California's budget crisis and the elimination of the vehicle license fee backfill revenue. Therefore, from a good government fiscal policy standpoint, it is recommended that if the TOT proposal is put forward to the voters, the MOE provisions be eliminated and new, more appropriate provisions be provided. Furthermore, guaranteed allocations to private organizations without the provision of mandatory requirements and services provides for little accountability to the City and raises questions about the return the City may receive for the investment.

If the City Council agrees to pursue a TOT increase, then the modifications listed in this report should be implemented in order to protect the City in times of fiscal hardship and ensure the best use of this proposed revenue increase.

Respectfully submitted,

Lisa Irvine
Financial Management Director

Approved: Michael T. Uberuaga
City Manager

IRVINE/MJK

Attachment 1: Property, Sales, and Safety Sales Tax vs. Public Safety Expenditures

Attachment 2: City Attorney Memorandum on Analysis of Emergency Services, Roads & Tourism Initiative, dated 08/21/2003

Attachment 3: Council Policy 100-03

Attachment 4: TOT Discretionary Revenue: Current vs. Proposed