



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: May 19, 2017

IBA Report Number: 17-21

City Council Docket Date: May 22, 2017

Item Number: 150

Discussion of the Proposed Ballot Measure to Increase the Transient Occupancy Tax (TOT)

OVERVIEW

On April 5, 2017, the Rules Committee received a report from the Office of the Mayor outlining a proposal to increase the City's TOT to finance: the proposed Phase III Contiguous Convention Center Expansion, additional road repair and maintenance, and expenditures to better address the City's significant homelessness issues (Proposal). While the staff report provided preliminary information for discussion of the Proposal, it did not include draft ballot language or revenue projections for the Committee to discuss. Reflecting on information provided in the days leading up to the Rules Committee meeting, our Office issued Report 17-14 (Attachment 1) to provide additional information and raise questions for Committee consideration.

Committee members made numerous comments and raised several questions about the Proposal. Although the action requested by staff was to direct the City Attorney's Office to work with the Mayor's Office to prepare a draft ordinance for Council consideration in June, the Committee supported the IBA's recommendation that the item be heard by the Council in May to allow the full City Council additional time to review, discuss, and provide input on the Proposal. The Proposal continues to be developed and is scheduled for City Council discussion on May 22, 2017. A new staff report has been docketed with draft ordinance language and projected revenue and expenditure detail.

Our Office has reviewed the staff report and draft ordinance docketed for Council discussion on May 22nd. Additionally, we have reviewed the May 12th memorandum responding to questions raised in the May 1st memorandum from Councilmembers Bry, Ward, and Gomez related to the Proposal. This report discusses information provided in the staff report and also highlights key provisions of the Proposal that have been added or clarified since the Rules Committee meeting. The report concludes with recommendations for the Council to consider and potentially request for inclusion into the draft ordinance.

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FISCAL/POLICY DISCUSSION

Key Elements of the Proposal

If approved by two-thirds of the voters, the TOT collected by hotels in the City would be increased by 1%, 2%, or 3% (depending on the geographic location of the hotel) beginning on April 1, 2018. The tax increase would continue for a period of up to 40 years from the last day of the month in which long-term bonds are first issued to finance the Convention Center expansion (currently projected for FY 2020). Staff estimates \$55 million of new TOT revenue would be received in the first full fiscal year of the tax increase (FY 2019).

Annual tax revenue is projected to grow by the TOT percentage growth projections included in the FY 2018 - 2022 Five-Year Financial Outlook and thereafter by an annual average growth rate of approximately 3.3% (extrapolated from historical and cyclical TOT growth patterns). The IBA believes the forecasted rates of TOT growth over the term of the proposed tax increase are reasonable based on historical data. If actual growth rates are higher or lower than projected, revenue from the tax increase could be significantly higher or lower than projections.

Revenue from the tax increase is to be apportioned in the following percentages: Convention Center Revenue Account (64%), Street Repair Revenue Account (18%), and Homelessness Revenue Account (18%). The table presented in attachment 1 of the staff report (Attachment 2) projects total revenue of \$5.2 billion over the proposed 42 year TOT increase through FY 2060. Additionally, the table shows the projected annual allocation for each of the three defined expense categories for the first 10 years and every five years thereafter.

The table further breaks out defined sub-categories of eligible expense for the Convention Center. In a suggested funding priority order, these include:

1. Debt service on bonds issued for expansion and modernization costs
2. Convention Center costs for ongoing operations, maintenance & repair, and capital
3. Annual payments the City makes to support Convention Center operations (includes dewatering)
4. Convention Center Business Development Programs (assumes \$4 million annually)

The final line in the table projects funds remaining in the Convention Center category after each of the sub-category items listed above have been fully satisfied. Based on these projections, tax revenue in excess of projected Convention Center needs would begin to accrue in FY 2038. The Proposal has been updated to allow the Mayor and City Council the option of redirecting excess Convention Center revenue, when available, to fund additional Homelessness or Street Repair expenditures. Current projections show that excess funding for these two categories will not likely be available until FY 2038 (20 years out).

Proposal Provisions Added or Clarified since the Rules Committee Discussion

A draft ordinance (Ordinance) has been developed and docketed for discussion on May 22nd. The Ordinance is intended to specify all of the pertinent details of the Proposal. Key provisions of the Proposal that have been added or clarified in the Ordinance since the Rules Committee discussion on April 5th are summarized below:

Allocation of Additional Tax Revenues - Section 35.0204(b)

This section defines apportionment percentages for the Additional Tax proceeds over the three main expenditure components as follows: Convention Center Tax Component (64%), Street Repair Tax Component (18%), and Homelessness Program Tax Component (18%). These percentages can only be modified by Section 35.0207(c) if a “Tax Allocation Triggering Event” has occurred in any fiscal year.

Tax Allocation Triggering Event - Section 35.0207(c)

A “Tax Allocation Triggering Event” (TATE) is a defined term found on page 12 of the Ordinance that relates to the Convention Center Tax Component. A TATE occurs when available funds remain after all eligible and defined expenses within the Convention Center category have been satisfied. In this circumstance, section 35.0207(c) allows the Mayor to propose and the City Council to consider and approve a revised percentage allocation on an annual basis. In response to the interest of some Councilmembers to increase the allocation to Homelessness Programs, this was an option presented in IBA Report 17-14. This section of the Ordinance allows for the possibility to shift available funds to either Homelessness Programs or Street Repairs. Although Attachment 2 projects approximately \$909 million of excess funding above Convention Center needs over the 42 year tax increase, the funding is not projected to begin to become available until FY 2038 (20 years out). Most of the projected excess funding is not projected to be available until the last 12 years of the tax proposal.

Definition of “Street Repairs”

This definition begins on page 11 of the Ordinance. In addition to the most obvious items associated with the repair and maintenance of streets (resurfacing and reconstruction, slurry seal, street sweeping, striping and re-striping, etc.), this definition also allows for the installation, repair and maintenance of sidewalks, curbs, guardrails, streetlights, traffic signals, street signs, traffic signs, and the maintenance of utilities or storm water infrastructure related to streets and the public right-of-way. The definition also allows for the installation, repair, and maintenance of accessibility upgrades or improvements to streets and public right-of-way in compliance with the Americans with Disabilities Act of 1990. The broad definition of “Street Repairs”, particularly for the inclusion of sidewalks, was an important feature for some Councilmembers.

Definition of “Convention Center Expansion and Modernization Costs”

This definition is found on page 9 of the Ordinance. This definition includes, but is not limited to, annual debt service payments for bonds or other forms of debt issued to finance the Convention Center expansion. These costs are shown as the first line item sub-category of expense for the Convention Center in Attachment 2.

Definition of “Convention Center Operating Costs” and “Convention Center Operations”

These definitions are also found on page 9 of the Ordinance. The eligible expenses provided for in these definitions are also reflected in the second line item of Convention Center expense shown in Attachment 2 (entitled Convention Center Ongoing Operations, Maintenance & Repair and Capital). These expenses include the costs to maintain, operate, and repair the Convention Center in a way that meets or exceeds the standard of “Good” physical condition as measured by the Facilities Condition Index (FCI). Additionally, these definitions allow tax proceeds to be used for annual debt service payments on the I-Bank loan currently being used to finance capital improvements at the Convention Center.

Definition of “Convention Center Business Development Programs”

This definition is found on page 8 of the Ordinance. This is a new defined eligible expense that was not presented or discussed at the Rules Committee meeting on April 5th. To the extent tax proceeds are available, they can be used for “any program that utilizes industry practices and standards in competitive sales, marketing, advertising, and customer incentives in an effort to spur economic growth and usage of the Convention Center.” These Business Development Programs are not described more specifically in the staff report. Our Office asked Convention Center staff for examples of what these programs might entail. Convention Center staff explained that rent subsidies (discounting the rent for the Convention Center facility) are commonly used in the industry as an effective marketing tool to entice meeting planners to book conventions or trade shows at the facility. On rare occasions, discounts could be offered on operating charges (food & beverage, telecommunications, etc.). It is important to note that as a new sub-category of eligible expense, tax proceeds utilized here necessarily reduce the amount and timing of excess funds that might otherwise become available under Section 35.0207(c).

Issuance of Bonds – Section 35.0211

This section authorizes the City to issue and sell Bonds secured by Additional Tax proceeds to finance Convention Center, Street, or Homelessness improvements. Section 35.0211(g) specifies that the Bonds shall be limited obligations of the City payable solely from Additional Tax Revenues. This section further specifies that Bonds shall not be deemed to constitute a debt or liability of the City’s General Fund.

Tax Proceeds excluded from City’s Infrastructure Fund – Section 35.0206

This section states that the Additional Tax is not unrestricted TOT revenue and therefore Additional Tax Revenues are not subject to San Diego City Charter section 77.1 related to the City’s Infrastructure Fund.

Annual Budgets – Section 35.0207

Beginning with the FY 2019 Annual Budget for the City, and continuing for each successive year until all tax proceeds have been expended, this section requires that the Mayor propose and the Council approve an itemized annual budget for the expenditure of funds in each of the Revenue Accounts (Convention Center, Street Repair, and Homelessness).

Required Annual Reporting by CFO - Section 35.0209(a)(b) and 35.0211(i)

Within 270 days after the close of each fiscal year until all tax proceeds have been expended, Section 35.0209(a) requires the CFO to prepare and submit to the City Council an annual report describing: tax revenues collected in the preceding year for each of the three major expenditure components, tax revenues expended in the preceding year for each of the three major expenditure components, and the status of all Special Purpose Activities (as defined) required or authorized to be funded by the Ordinance consistent with the annual budget approved by the City Council for the applicable fiscal year. Section 35.0209(b) requires the annual report to be docketed as an information item at a City Council meeting within 60 days of report submission. As long as any proceeds of Bonds remain unexpended, Section 35.0211(i) requires the CFO to file another report with the City Council that (1) states the amount of Bond proceeds received and expended in that year and (2) provides the status of any project funded or to be funded from proceeds of the Bonds.

Required Performance Audits by City Auditor - Section 35.0210

This section requires the City Auditor to conduct a performance audit for each Revenue Account (Convention Center, Street Repair, and Homelessness) on a rolling 3-year basis – so each Revenue Account is audited every three years beginning with the Convention Center Account in FY 2021. The purpose of each performance audit is to verify that expenditures during the applicable time period have occurred as required by the Ordinance. Audit reports will be issued to the City Council and the City Council can request the City Auditor to present any performance audit at a public Council or Committee meeting.

Use of Additional Tax Revenues - Section 35.0203(c)

During the Rules Committee meeting, Councilmember Cate expressed his concern that this measure not be allowed to supplant current City expenditures made for Streets or Homelessness. This section provides that “Additional Tax Revenues will supplement, rather than replace, any existing revenue sources that the City has been using to support Street Repairs and Homelessness Programs before the initial imposition of the Additional Tax.”

Recommendations for Council to Consider and/or Request for Inclusion in the Ordinance

After reviewing the docketed information, our Office makes the following recommendations for Council consideration:

Add Requirement that Annual Convention Center Operating Revenues be Spent in Conjunction with Receiving Tax Proceeds

The City created the Convention Center Corporation (Corporation) to manage, market and operate the Convention Center. Including a \$3.4 million annual support payment from the City, the Corporation has generated approximately \$36 million in revenues from operations in recent years (from facility rent, food & beverage sales, services provided, etc.). The last few years have been record setting years for the Corporation and it has used its operating revenue to cover operating costs (personnel costs, repair and maintenance, utilities, etc.), fund some capital needs, and maintain a reasonable financial reserve. In years where the Convention Center is busy with quality conventions and events, the Corporation may be able to cover its annual operating expenses and significantly grow its financial reserves.

The Proposal would allow an appropriate amount of tax proceeds to be available to help the Corporation address its annual operating costs and capital needs (when tax proceeds are available). Using tax proceeds to help the Corporation cover its annual operating and capital needs in years where the Corporation's operating revenues significantly exceed operating costs could result in the Corporation accumulating unreasonably high reserves, or result in excessive/unnecessary expenditures when tax proceeds could otherwise be used for other defined purposes in the Proposal. **In order to avoid the possibility of this situation in the future, the IBA recommends the City Attorney develop a provision within the Ordinance requiring the Corporation to fully expend its operating revenues in conjunction with receiving a sufficient amount of tax proceeds, when available, to satisfy all reasonable operating and capital needs and maintain a reasonable financial reserve.** This provision would be intended to limit the annual infusion of tax proceeds, when available, to an amount sufficient to reasonably meet all operating and capital needs in any given year thereby making additional tax proceeds available to potentially address the other targeted needs identified within the Ordinance.

Assign Funding Priority Order to Convention Center Expense Categories

The Ordinance defines several broad categories of Convention Center expenses that are eligible for tax proceeds resulting from the Proposal but does not stipulate a funding priority order for these expenses. As shown in Attachment 2, projected tax proceeds are insufficient to cover all of these eligible expenses in the first 15 years of the proposed TOT increase. This raises the question of which expenses to fund first with available tax proceeds. **The IBA recommends the City Attorney be asked to amend the Ordinance to establish a funding priority order for eligible Convention Center expenses.** The order shown in the table in Attachment 2 is reasonable but does not directly correlate with definitions in the Ordinance. We suggest available tax proceeds be used in the following funding priority order:

- 1) debt service on facility expansion bonds or notes
- 2) funding to support the maintenance, operation, and repair of the Convention Center to ensure that it meets or exceeds the standard of "Good physical condition" as measured by a Facilities Condition Index (FCI) rating
- 3) funding to cover approximately \$4 million of annual support payments made by the City to the Corporation in support of long-term marketing, capital, and dewatering expenses
- 4) additional funding to support Convention Center Business Development Programs

Narrow the Definition and Establish an Expenditure Cap for Convention Center Business Development Programs

This new expense category is broadly defined in the Ordinance. The staff report does not discuss specific types of successful business development programs or describe how they are used by the industry to increase usage of convention center facilities. Convention Center staff has informed our Office that rent credits are commonly used to secure convention and trade show commitments. Other possibilities might include discounts on service charges (food & beverage, telecommunications, etc.) or direct marketing at meeting planner conventions. As compared to more generalized destination marketing strategies, these business development strategies would appear to be more likely to result in increased usage of the Convention Center. **As the Corporation already budgets for some of these expenses, the IBA recommends City staff consult with Convention Center staff in an effort to 1) narrow the definition to proven and cost-effective business development programs and 2) establish a reasonable annual expenditure cap for these expenses considering the other competing needs delineated within the Ordinance (the footnote for this expense in Attachment 2 assumes \$4 million annually).**

Require Five-Year Implementation Plans for Street Repair and Homelessness Expenditures

Section 35.0208 of the Ordinance requires the City Council to approve a five-year implementation plan describing how the City will allocate existing and projected funds for Homelessness Programs including the order of priority for the identified programs. **Our Office recommends the Ordinance be amended to specify that the Mayor develop a proposed five-year Homelessness Program implementation plan for the City Council to review and approve.** The Ordinance could require the proposed five-year implementation plan be developed annually, or bi-annually, in conjunction with the itemized annual budget (required by Section 35.0207) to adjust for ever changing circumstances and needs.

Our Office further recommends the City Attorney be requested to develop a similar provision for inclusion in the Ordinance requiring the Mayor to develop a proposed five-year Street Repair implementation plan for the City Council to review and approve. The five-

year implementation plan should endeavor to provide detail for all of the types of improvements described in the definition of Street Repairs beginning on page 11 of the Ordinance. Additionally, the plan should:

- (1) Reflect the level of funding needed to achieve the Mayor's goal of maintaining an average Overall Condition Index (OCI) of 70 for City streets;
- (2) Include the funding sources planned to address the need; and
- (3) Account for new revenue streams available for streets. In addition to the TOT tax proceeds resulting from the Ordinance, the plan should include revenue resulting from the passage of Senate Bill 1.

The purpose of the five-year implementation plan would be to provide a clear funding strategy that will keep the City on track to meeting its goals for streets. The plan would also provide Council with an idea of the funding available from the Infrastructure Fund and from commercial paper financing to use for non-street purposes.

Include OCI Goals into the Definition for Street Repairs


A description of the OCI measure and the expressed intent to maintain and exceed an OCI of 70 on City streets is provided in the "Whereas clause" portion of the Ordinance. If the Ordinance is placed on a future ballot and subsequently approved by voters, our Office understands that the "Whereas clause" section of the Ordinance is typically not codified into the San Diego Municipal Code. **As the goal to meet or exceed an OCI of 70 is an important objective of the Proposal, the IBA recommends the OCI goal be reiterated or moved into the Definitions section of the Ordinance and included under the definition of Street Repairs.** This change would be consistent with the reference to FCI in the definition of Convention Center Operations. It would also ensure that this important goal is explicitly codified into the San Diego Municipal Code.


Replace all References to "City Manager" in the Ordinance with "Mayor"

Unless there is a legal reason for continuing to refer to City Manager instead of Mayor, the IBA recommends the Ordinance be amended to replace all references to City Manager with Mayor. The City has been in a Mayor-Council form of government since 2006 and been without a City Manager since 2005. In addition to the potential for voter confusion, continued references to City Manager in new legislation work against efforts to update the City's Charter and Municipal Code.

CONCLUSION

The IBA has reviewed the information docketed for the May 22nd City Council discussion of the proposed TOT increase to finance the Convention Center expansion, additional street repairs, and homelessness programs. This report summarizes the Proposal, discusses tax revenue and expenditure projections, and highlights key provisions of the Ordinance that have been added or clarified since the Rules Committee discussion on April 5th. The report concludes with recommendations for the Council to consider and potentially request for inclusion into the next iteration of the proposed Ordinance.


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- Attachments:
1. IBA Report 17-14
 2. Attachment 1 of the Staff Report dated May 12, 2017 – table entitled Projected Funding by Tax Component (FY 2019 – 2060)

**THE CITY OF SAN DIEGO**

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: April 4, 2017**IBA Report Number:** 17-14**Rules Committee Date:** April 5, 2017**Item Number:** 1

Additional Information related to the Proposed Ballot Measure to Increase the Transient Occupancy Tax (TOT)

OVERVIEW

On March 29, 2017, the Office of the Mayor issued a report outlining a proposal to increase the City's TOT in order to finance the proposed Phase III Contiguous Convention Center Expansion, fund additional road repair and maintenance, and establish a dedicated revenue stream to more significantly address the City's significant homelessness issues. The Rules Committee will receive a presentation of this proposal on April 5th. Committee members are being asked to comment and provide direction regarding the Mayor's proposal. Staff is specifically requesting that the Committee direct the City Attorney's Office to work with the Mayor's Office to prepare a draft ordinance for consideration by the City Council in June to place on the ballot for a special election in November of 2017.

The IBA was briefed about the proposed TOT increase late last week and received additional information about underlying assumptions behind preliminary tax revenue projections this week. We understand that the proposal is still under development and certain elements may be subject to change.

If the current proposal were to be placed on the November ballot and be adopted by two-thirds of the voters, the TOT levied by the hotels in the City would be increased by 1%, 2%, or 3% (depending on the geographic location of the hotel) beginning April 1, 2018 for a period of up to 40 years. It is estimated that \$53.5 million of new TOT revenue would be received in the first full fiscal year of the tax increase (FY 2019). This amount is conservatively projected to grow annually by approximately 3% over the term of the tax increase.

This report endeavors to provide additional information and supplement information presented in the Mayor's staff report and memorandum docketed for the Committee. We additionally highlight other considerations and options for the Committee to contemplate in its review of this proposal.

FISCAL/POLICY DISCUSSION

The Proposed TOT Increase

The City's current TOT is 10.5% for all hotels in the City. Additionally, hoteliers renewed their Tourism Marketing District (TMD) in 2013 for another 39.5 years. The TMD requires all hotels with 70 rooms or more to assess their guests, or alternatively pay, an additional 2%. The 2% assessment is used to fund programs and services that benefit the assessed lodging businesses such as tourism marketing and promotion. This results in a current combined charge to hotel guests staying at the City's larger hotels of 12.5%.

Similar to the proposed TOT increase in 2012 to finance the Phase III Convention Center expansion, the current proposal would also increase TOT by 1%, 2% or 3% depending on the geographic location of the hotel in the City. Generally, hotels closest to the Convention Center (those in the downtown area) will be required to increase their TOT levy by 3% (to 15.5%), those outside of the downtown area by 2% (to 14.5%), and those furthest from downtown by 1% (to 13.5%). One difference between the proposed 2012 TOT increase and the current proposal is that the tax area boundaries have been modified as described in Table 1.

Table 1: Current and Proposed TOT Levy by Tax Area				
Tax Area	Current 10.5% TOT + 2% TMD Assessment*	Proposed Tax Increase	Proposed New TOT + TMD Assessment*	Applicable Tax Area
1	12.5%	1.0%	13.5%	Citywide
2	12.5%	Add 1.0%	14.5%	South of Hwy 56, North of Hwy 54 & Downtown
3	12.5%	Add 1.0%	15.5%	Downtown Area

*Hotels with fewer than 70 rooms do not pay the 2% TMD assessment and have TOT rates that are 2% lower.

Table 2 shows the number of hotel rooms, applicable TOT increase, and associated revenue in FY 2019, and the proposed utilization of the tax proceeds collected in tax area.

Table 2: Estimated New TOT Revenue in FY 19 for each Tax Area and Proposed Utilization				
Tax Area	Number of Hotel Rooms Subject to Applicable Tax	Applicable TOT Increase	Projected New Revenue in FY 2019	Proposed Utilization of Tax Area Proceeds
1	48,655	1.00%	\$22.4M	Primarily for Homelessness & Streets
2	44,700	1.00%	\$21.7M	Entirely for Convention Center Expansion, Capital & O&M
3	16,022	1.00%	\$9.4M	Entirely for Convention Center Expansion, Capital & O&M

Proposed Allocation of the TOT Increase

The following allocation detail is based on preliminary information shared by the Office of the Mayor and is potentially subject to change after consideration of City Council and City Attorney input. As noted in Table 2, proceeds from the first full year of the proposed TOT increase (FY 2019) are currently estimated to be \$53.5 million. This estimate includes approximately 1,300 new hotel rooms that are planned to open in FY 2017 and FY 2018.

All City hotel rooms would be subject to a 1% TOT increase to be applied in Tax Area 1. Hotel rooms in Tax Area 2 would be subject to an additional 1% TOT increase and hotel rooms in Tax Area 3 would be subject to yet another 1% TOT increase. New TOT tax proceeds would be allocated in accordance with the defined uses for the tax proceeds collected in each tax rate area as described below:

Tax Area 1: As proposed, approximately 90% of the new TOT proceeds from Tax Area 1 (an additional 1% levied on all hotel rooms citywide) would be split to fund street improvements and efforts to address homelessness over the term of the TOT increase. Approximately 10% of the new TOT proceeds from Tax Area 1 would be used to fund the Phase III Convention Center expansion and potentially used to address a) other capital or operating and maintenance expenses at the facility or b) other yet to be specified tourism related expenses. Total Tax Area 1 proceeds for FY 2019 estimated to be \$22.4 million, of which approximately \$20 million would be split to address streets and homelessness needs.

Tax Area 2: All of the new TOT proceeds from Tax Area 2 (the additional 1% levied on those hotels within the boundaries of Tax Area 2) would be used to fund the Phase III Convention Center expansion and potentially used to address a) other capital or operating and maintenance expenses at the facility or b) other yet to be specified tourism related expenses. Total Tax Area 2 proceeds for FY 2019 estimated to be approximately \$21.7 million.

Tax Area 3: All of the new TOT proceeds from Tax Area 3 (the additional 1% levied only on downtown hotels within the boundaries of Tax Area 3) would be used to fund the Phase III Convention Center expansion and potentially used to address a) other capital or operating and maintenance expenses at the facility or b) other yet to be specified tourism related expenses. Total Tax Area 3 proceeds for FY 2019 estimated to be approximately \$9.4 million.

Assumed Annual Growth of New TOT Proceeds

The City's average annual growth rate for TOT has significantly exceeded 3% over the last 10 (3.5%), 20 (5.4%), and 30 (6.1%) year periods. Based on their review of historical TOT, staff has developed a reasonable cyclical pattern of annual changes in TOT (5-6 years of growth followed by 1-2 years of decline) that averages to be approximately 3% over the period of the proposed TOT increase (up to 40 years). Given the City's historical TOT growth rates and the likelihood of additional hotels being added over time, the IBA believes this is a reasonable and potentially conservative estimate.

Based on the assumed average annual growth rate of approximately 3%, the amount of the annual allocation attributable to the proposed TOT increase grows significantly over time. While total tax proceeds are preliminarily estimated to be \$53.5 million in FY 2019, they could reasonably be approximately four times that amount in the 40th year of the tax (FY 2058). As noted in the staff

report, preliminary revenue projections would be sufficient to finance all costs associated with the Phase III Convention Center Expansion.

Other Considerations Related to the Proposed TOT Increase

Baseline TOT Growth Attributable to Phase III Convention Center Expansion

The Mayor's staff report (page 2) indicates the proposed Phase III Convention Center Expansion will generate over 380,000 new hotel room nights annually that will in turn result in approximately \$15 million in additional TOT to the City's General Fund for core City services. The Mayor's Office indicates this data was provided by a TMD consultant analyzing the proposed Convention Center expansion (the consultant's analysis has yet to be released). In comparing the above figures with estimation approaches included in the docketed memorandum from the DCOO of Public Works to the COO dated March 27, 2017, we find that the 380,000 new hotel room nights estimate reasonably fits within the high end of the range established by the two approaches detailed in the memorandum to the COO. However, with respect to the estimate for additional TOT revenue for the City's General Fund, we find the \$15 million estimate to be overstated and significantly out of the range established by the two alternative approaches detailed in the memorandum to the COO.

The data provided in the approaches included in the memorandum to the COO suggest additional annual TOT for the City's General Fund might range from \$4 million to \$9 million a year. Based on discussions with industry professionals and previous analysis done by our Office, we believe the \$4 million to \$9 million annual estimate to be more realistic. As this is an important estimate that is one of the key drivers for the proposed tax increase and the Phase III Convention Center expansion, the IBA recommends the Committee and Council be provided a copy of the consultant's analysis, once released, and/or any other credible analyses estimating potential additional TOT funds for the City's General Fund attributable to the Phase III Convention Center expansion.

Options for Increased Funding to Reduce Homelessness

Our Office has been asked if it would be possible to increase the amount of funding to address homelessness issues over the term of the proposed TOT increase. One way to do this would be to simply increase the proposed TOT increase in Tax Area 1. Another method would be to alter the proposed TOT allocation to shift some of the tax proceeds away from the Convention Center and/or street repairs in order to increase funding to better address homelessness issues. It should be noted that the Mayor's Office strongly believes that such a modification significantly reduces the likelihood of voter approval, noting that the City currently does not have a spending plan for additional homelessness funds.

An alternative option might be to amend the proposal to allow TOT received over and above the amount necessary to finance the Phase III Convention Center expansion, net capital, and operating and maintenance costs, if any, to be allocated to homelessness programs/services. The IBA has reviewed preliminary projected TOT revenue and Convention Center expense data which suggests that there could be significant additional funds available after paying for all of the Convention Center-related costs addressed in the staff report. Unless there are other, yet to be specified, Convention Center-related expenses to be funded with the proposed TOT increase, this approach might allow additional funding to be used for homelessness programs/services (or alternative public infrastructure) without significantly disturbing the proposed TOT allocation methodology for the Convention Center and street repairs.

Questions related to Future Road Repairs

Improving the condition of our streets and roads continues to be a top City priority. Over the past several years the Mayor and City Council have increased funding allocated to street repair, and significantly increased the miles of streets repaired each year. As a result of these efforts, the most recent streets condition assessment, completed in 2016, showed that City Streets had an Overall Condition Index (OCI) rating of 72, which indicates that the average condition of City streets is good. In that condition assessment, 60% of individual City streets were found to be in “good” condition, 34% in “fair” condition, and 6% in “poor” condition. One of the Mayor’s stated goals for allocating a portion of the proposed TOT increase to street repair is to reach and maintain an OCI of 70 or greater in each individual San Diego neighborhood.

TOT dedicated to road repairs is forecast to total \$900 million over the proposal’s 40 year term. If the Council desires to issue bonds to be repaid with the first 30 years of TOT revenue, approximately \$150 million could be raised in FY 2019. Our office believes it is important that an expenditure plan be developed for a potential FY 2019 street repair bond issuance and that potential uses for the last 10 years of the 40 year increase also be contemplated.

To meet and maintain the street condition goals discussed above, the 2018-2022 Five Year Capital Infrastructure Outlook, issued in January 2017, shows a plan over the next five years to complete 445 miles of asphalt overlay and concrete street replacement, at an estimated cost of \$227 million. The Capital Outlook shows this five year plan to be 100% funded through FY 2022, largely with future planned lease revenue bonds and Transnet funds. The FY 2018-FY 2022 Financial Outlook indicates that the Mayor plans to issue three series of \$90 million lease revenue bonds – one in FY 2018, the second in FY 2020 and a third in FY 2021 - for infrastructure purposes. The Five Year Capital Outlook earmarks \$126 million of these lease revenue bonds as a funding source for street repair.

Given this, it will be important to clarify whether TOT revenue in the proposal will replace the need for lease revenue bonds for street repair. Provided that it does, Council should be apprised as to whether the Mayor’s Office still plans to move forward with the lease revenue bond issuances for other infrastructure needs, such as facility repair, sidewalks, fire stations, parks, libraries, streets, and storm water permit compliance efforts. The Five Year Capital Outlook also calls for 1,515 miles of slurry seal at an estimated cost of \$151 million over five years to meet street OCI goals. As slurry seal is considered an operating cost and not a capital cost, new TOT revenue could be used for slurry seal, but it should be used for this purpose on a pay-as-you go basis. Slurry seal is currently funded through a combination of funding from Gas Tax and Prop 42 revenue, Transnet, and the City’s General Fund. A dedicated stream of TOT revenue could help free up these General Fund dollars for other needs.

While there will always be a need to fund street repair, particularly to meet the goal of maintaining an OCI of 70 over the long term, no other specific expenditure plans for street repair have been made available beyond five year plan reflected in the FY 2018-2022 Five Year Capital Outlook, as discussed above.

Fifth Avenue Landing (FAL) Property

FAL is a developer with a controlling leasehold interest in approximately five acres of bayfront property needed for the envisioned Phase III Convention Center Expansion. The developer is planning to construct a 44-story, 4-star, \$300 million hotel on the property but still needs to obtain important approvals for their project from the Port and the Coastal Commission which could take more than a year. FAL has initiated a lawsuit against the Convention Center Corporation alleging they are undermining their development plans. As the City Council contemplates a proposed ballot measure for a November special election, it will be important to monitor the situation with the FAL property and also consider whether the ability to use TOT proceeds to potentially acquire the rights to develop the FAL property need to be built into the proposed ballot measure.

Legal Considerations

The Office of the City Attorney will need to have a clear understanding of the City Council's objectives for this proposed ballot measure, if it is to be advanced, to ensure the resulting ordinance 1) clearly conveys its intent to the voters, 2) complies with all applicable laws and 3) can withstand any possible legal challenges. As elements of this proposal are still under review and development, it will be critical for the City Attorney's Office to have time to incorporate all aspects of the City Council's intent and for the City Council to have sufficient time to review the resulting ordinance before the deadline for submission to the Office of the City Clerk in late July.

Need for Enhanced Expenditure Detail

Our Office has received inquiries about the proposal concerning how the City specifically plans to spend TOT proceeds for road repairs and helping the homeless. The City currently exceeds its Overall Condition Index (OCI) goal of 70 for streets and uses multiple sources of revenue to maintain this goal. While the staff report indicates a new source of noncapital funding is needed for slurry seal and other street maintenance activities to maintain an OCI of 70, it may be helpful to provide additional detail for how the funds are envisioned to be expended. The staff report further states that a dedicated revenue stream will help address homelessness issues using long-term regional efforts and a non-exhaustive list of other possible services. It may be beneficial to provide voters with additional specificity about planned homelessness expenditures if it should become available.


It is also possible that there would be additional funding above that needed to finance the Phase III Convention Center expansion, net capital, and operating and maintenance costs. If so, it will be important for the measure to specify the eligible expenditures for these TOT proceeds.

Timing


The current plan calls for the Mayor's Office to work with the City Attorney's Office to develop an ordinance in support of the proposed TOT increase for City Council consideration in June. This will be the first public opportunity for the City Council to review a multi-faceted ordinance to increase the City's TOT rate for a period of up to 40 years. Should the City Council have significant questions or concerns in June, or wish to make changes to the ordinance, the City Attorney's Office would have limited time to make the requested changes and return to Council before the deadline for submission to the Office of the City Clerk in late July.

CONCLUSION

This report provides additional information, considerations and raises questions for the Committee to consider or ask of staff. Given a number of outstanding questions concerning the proposal, the short timeframe for review, and the time available between the Rules Committee meeting on April 5th and a proposed City Council meeting in June, we recommend this item be returned to Committee or City Council in May for further review, discussion and updates.



Jeff Kavar
Deputy Director



APPROVED: Andrea Tevlin
Independent Budget Analyst

**Proposed Ballot Measure – Special Lodging Tax Levy
Projected Funding by Tax Component (FY 2019 – 2060)
ESTIMATES**

Annual (FY2019–2028) & Cumulative Revenue and Allocations Projections																		
(\$Mill)	FY19	FY20	FY21	FY22	FY23	5 YR TOTAL (FY23)	FY24	FY25	FY26	FY27	FY28	10 YR TOTAL (FY28)	15 YR TOTAL (FY33)	20 YR TOTAL (FY38)	25 YR TOTAL (FY43)	30 YR TOTAL (FY48)	40 YR TOTAL (FY58)	42 YR TOTAL (FY60)
ANNUAL GROSS SPECIAL LODGING TAX REVENUE ⁽¹⁾	\$55	\$58	\$61	\$64	\$64	\$302	\$63	\$68	\$74	\$80	\$85	\$672	\$1,110	\$1,645	\$2,286	\$2,996	\$4,817	\$5,219

Projected Allocations:

Street Repairs (18%)	\$10	\$11	\$11	\$12	\$12	\$55	\$12	\$12	\$13	\$15	\$16	\$123	\$203	\$300	\$417	\$547	\$879	\$952
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Homelessness Programs (18%)	\$10	\$11	\$11	\$12	\$12	\$55	\$12	\$12	\$13	\$15	\$16	\$123	\$203	\$300	\$417	\$547	\$879	\$952
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Convention Center (64%)	\$35	\$37	\$39	\$41	\$41	\$192	\$40	\$44	\$47	\$51	\$54	\$427	\$705	\$1,045	\$1,452	\$1,903	\$3,060	\$3,315
<i>Convention Center Expansion and Modernization Costs</i>	\$35	\$37	\$39	\$41	\$41	\$192	\$41	\$41	\$41	\$41	\$41	\$394	\$597	\$799	\$1,002	\$1,204	\$1,326	\$1,326
<i>Convention Center Ongoing Operations, Maintenance & Repair and Capital ⁽²⁾</i>	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$3	\$6	\$10	\$14	\$33	\$105	\$204	\$317	\$450	\$782	\$861
<i>City Convention Center Support Payments ⁽³⁾</i>	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$4	\$25	\$47	\$68	\$111	\$119
<i>Convention Center Business Development Programs ⁽⁴⁾</i>	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$12	\$32	\$52	\$92	\$100
<i>Projected Excess Funding above Convention Center Needs</i>	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$6	\$55	\$130	\$749	\$909

- (1) Revenue estimates are based on FY2018–2022 Five-Year Financial Outlook TOT projections and projected future TOT economic cycles which generally assume 5 years of growth followed by one year of decline and one year of no growth (7 year economic cycles) producing average annual projected growth rate of approximately 3.3%.
- (2) No funding projected to be supported from Special Lodging Tax for Convention Center Ongoing Operations, Maintenance & Repair and Capital in FY2019–2024; partial funding projected in FY2025 and full funding projected beginning FY2033.
- (3) Based on current level of City Convention Center Support Payments of \$3.4 million and City funding of annual dewatering costs (\$840,000); no escalation assumed. No funding projected to be supported from Special Lodging Tax for City Convention Center Support Payments in FY2019–2032; partial funding projected in FY2033 and full funding projected beginning FY2034.
- (4) Assumes \$4 million annual allocation.

Notes:

- Numbers may not sum due to rounding; rounded to nearest \$million
- FY 2019 is first full year of Special Lodging Tax levy collection