

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: April 30, 2007

IBA Report Number: 07-47

City Council Docket Date: May 1, 2007

Item Number: 330

Subject: Tourism Marketing District Procedural Ordinance

OVERVIEW

On Tuesday, May 1, 2007, the City Council will consider the first of several steps required to establish a Tourism Marketing District (TMD) in the City of San Diego. The TMD would be an assessment district created by the City on behalf of larger hotel and motel operators within the City. The TMD would raise funds to promote tourism in the City and be established in accordance with new language that is proposed for incorporation into the City's Municipal Code. Formation steps for the TMD would be modeled after assessment districts created pursuant to the State's Property and Business Improvement District Law of 1994. For more detailed information on the TMD characteristics and process, please refer to IBA Report 07-46 pp. 27-29, IBA Analysis of the Mayor's FY 2008 Proposed Budget. This report will discuss our approach to the TMD and items for consideration in decision-making.

FISCAL/POLICY DISCUSSION

The IBA first emphasizes that this policy discussion should take place outside of the context of the current budget process. Although we know that the Mayor has proposed his FY 2008 Budget with the inclusion of the budgetary benefits of the TMD, we urge the City Council not to allow that to influence a decision that should rest entirely on the policy merits of the proposal.

As stated in IBA Report 07-46 on the Mayor's Proposed Budget, it is our belief that the TMD impacts should not be included in the budget, primarily due to a relatively high level of uncertainty at this time. We have identified in our report ways to offset the removal of these TMD savings from the FY 2008 Budget. As we described in that report, there are a number of steps in the process of the formation of the TMD. Notwithstanding the LIA and HMA support for this proposal, the petition and ballot process may return results that are inconsistent with the conclusions drawn in the Proposed Budget. Due to this uncertainty, and in accordance with the principle of conservatism, we have recommended approving the FY 2008 Budget without the reliance on the TMD.

Furthermore, a City Council decision to adopt this Procedural Ordinance would not modify our recommendation that TMD impacts be removed from the FY 2008 Budget. The IBA believes

that adoption of the Procedural Ordinance does not constitute sufficient certainty to include this item in the FY 2008 Budget. Approval of this Procedural Ordinance is simply the first step in a formation process with several steps, (two of which the City Council does not control), and it is important to note that the City Council's vote on this item will not assure TMD formation. Additionally, it is premature to anticipate the results of the critical vote of the hoteliers, just as it would be to anticipate the results of voter-approved bonds prior to a public vote. We believe this should provide reasonable assurance to the City Council that their vote today will not impact the financial position of the FY 2008 budget.

Should the TMD be approved, a mid-year adjustment to the budget would be appropriate to incorporate these changes. However, in the interim and as indicated above, the IBA has identified items that will mitigate the impact of removal of the TMD, and we are confident that a balanced budget can be passed without inclusion of this proposal, as we have recommended. Therefore, it is our belief that the City Council should be free to make this decision independent from the short-term concerns in the FY 2008 Budget. A longer-term perspective on this important policy matter should guide the decision.

We stress, however, that our recommendation to remove the financial impact of the TMD from the budget is not a judgment on the TMD proposal itself. Our recommendation is based on financial and budgetary best practices and does not preclude or oppose the formation and implementation of a TMD in the City of San Diego. With regard to the policy matter, the IBA is not prepared to take a position at this time, but we would provide the following items for consideration:

- The TMD is designed to provide needed funding for marketing for San Diego's tourism sector in what is a competitive industry.
- The TMD benefits one sector of our regional economy, but may not positively impact other important business sectors and economic drivers in our region.
- The implementation of a TMD may negatively impact the City's ability to raise TOT in the future. It should be noted that the City of San Diego has a low TOT rate, particularly for such a large and desirable destination. In addition, the City's total tax base is lower than most other similar cities. This action is likely to perpetuate that condition.
- A 2% assessment is significant (estimated by the IBA at over \$30 million in FY 2008). Under the TMD, the City would only receive the benefit of \$10 million expenditure savings annually. A similar TOT increase would allow the City to increase needed General Fund resources in excess of \$30 million and use that funding for a variety of purposes.
- However, it should also be noted that in 2004, citizens voted down ballot measures in two separate elections in one year that would have raised the TOT by 2%. While this is not conclusive, it may indicate lack of ability to raise the TOT to levels comparable to peer cities in the near-term.
- The TMD will relieve the City from funding certain non-profit and community groups in FY 2008 for an estimated savings of \$5 million.

- Except for the San Diego Convention and Visitors Bureau and the North San Diego Convention and Visitors Bureau, the City cannot be certain that relief from its funding of these non-profits is permanent. It is possible that groups that fail to earn funding from the TMD will return to request funding from the City in future years.
- Based on information provided, the TMD will use a robust investment strategy, requiring return on investment data, strong oversight and regular audits.
- Providing a significant increase in tourism marketing funding is anticipated to grow City TOT receipts faster than if the TMD were not established. The TMD will seek to drive demand that will keep occupancy and average daily room rates high, upon which TOT is based. Strong tourism also impacts sales taxes and other revenues.
- Potential grantees may be reticent to express concerns they may have for fear of reprisal if the TMD is implemented.

CONCLUSION

On Tuesday, May 2, 2007 the City Council will consider the Implementation Ordinance for a Tourism Marketing District. While the IBA is not prepared to take a position on this policy issue at this time, we hope to contribute a few thoughts for consideration.

The Mayor's Proposed Budget assumes implementation of the TMD around the January 2008 timeframe. Due primarily to the uncertainty of whether the TMD will be approved, the IBA has recommended that all impacts of the TMD be removed from the FY 2008 Budget at this time. It should be reiterated, however, that this recommendation is neither a judgment on the TMD proposal itself, nor prohibits its formation and implementation.

Finally, we again wish to emphasize that this policy decision should be made free from concerns about the FY 2008 Budget. We are confident that the FY 2008 Budget can be balanced without this savings and have already offered a number of recommendations to do so. The IBA will provide more information and analysis as requested and as necessary throughout this continuing discourse.

[SIGNED]
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