THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 2

Proposed Amendment to the Municipal Code Regarding Allocation of Transient Occupancy Tax Revenue

OVERVIEW

At the May 1, 2008 Budget Review Committee meeting, Council Member Frye introduced a proposal to amend the statutory requirements regarding the allocation of Transient Occupancy Tax (TOT) revenues. Currently, the Municipal Code requires that 5 cents of the City's 10 ½ cent TOT levy be deposited into the TOT Fund. Of that 5 cents, 4 cents are required to be used solely for the purposes of promotion, while the remaining 1 cent can be used for discretionary purposes as the Council may direct.

The proposal introduced by Council Member Frye would amend the Municipal Code to reduce the amount of TOT required to be allocated for promotional purposes from 4 cents to 2 cents, and require that 1 cent be allocated for San Diego Fire-Rescue Department facilities and equipment, and 1 cent be allocated for San Diego Police Department facilities and equipment.

Overall, this proposal would significantly benefit the General Fund by reducing the amount of TOT that is required to be allocated for promotion, and providing guaranteed funding for both Police and Fire-Rescue facilities and equipment. However, implementation of this proposal would require a reduction in existing TOT allocations, which may be difficult in the near future as a significant portion of existing allocations are for non-discretionary debt service payments.

FISCAL/POLICY DISCUSSION

Municipal Code Section 35.0128 governs the allocation of TOT funds for promotional purposes, requiring the 5 cents of the City's 10 ½ cent TOT levy be deposited directly in the TOT Fund. Of that 5 cents, 4 cents are to be used solely for the purposes of promotion, while the remaining 1 cent may be used for any purpose as directed by the City Council.

The proposal introduced by Council Member Frye at the May 1, 2008 Budget Review Committee meeting would amend the municipal code to reduce the amount of TOT that is required to be allocated for promotional purposes from 4 cents to 2 cents, and would require that 1 cent be allocated for Police facilities and equipment and 1 cent for Fire-Rescue facilities and equipment. It should be noted that the proposal would only require 3 cents of the City's 10 ½ cent TOT levy to be deposited into the TOT Fund, as the allocations for Police and Fire-Rescue facilities and equipment would go directly into the General Fund. The table below shows the current allocations per the Municipal Code, and the allocations as reflected in the proposal.

TOT Allocations in Cents

ALLOCATION	CURRENT	PROPOSED	
Promotional Purposes	4.0	2.0	TOT Fund
Council Discretionary*	1.0	1.0	
Police Facilities & Equip.	-	1.0	General Fund
Fire-Rescue Facilities & Equip.	-	1.0	
TOTAL	**5.0**	**5.0**	

** The 1 cent Council discretionary was transferred to the General Fund in FY 2009.*

The following table shows the current allocations per the Municipal Code, and the allocations as reflected in the proposal using FY 2009 budgeted dollar amounts.

TOT Allocations Using FY 2009 Budget Amounts

ALLOCATION	CURRENT	PROPOSED	
Promotional Purposes	65,911,874	32,955,937	TOT Fund
Council Discretionary*	16,477,968	16,477,968	
Police Facilities & Equip.	-	16,477,968	General Fund
Fire-Rescue Facilities & Equip.	-	16,477,968	
TOTAL	**82,389,842**	**82,389,842**	

** The 1 cent Council discretionary was transferred to the General Fund in FY 2009.*

As this table shows, Council Member Frye's proposal would allocate significant new funding to the General Fund for Police and Fire facilities and equipment. Using FY 2009 budgeted dollar amounts, this would hypothetically result in an additional $33 million for the General Fund.

Current TOT Allocations

The FY 2009 Budget adopted by Council on June 9, 2009 included approximately $66.3 million in TOT allocations from the Special Promotional Programs budget. These allocations are for Arts & Cultural programs, Capital Improvements, Economic Development programs, and Safety and Maintenance of Visitor-Related Facilities. It should be noted that these allocations include $7.5 million for General Fund promotion-related activities. In addition, $16.2 million in Council 1 cent discretionary TOT is transferred to the General Fund (which is slightly less than the full 1 cent as reflected in table above due to budget balancing). These allocations are shown in the table below.

TOT ALLOCATION	FY 2009 BUDGET	CENT-EQV.
Arts, Culture & Community Festivals	8,070,156	0.5
Capital Improvements*	36,158,513	2.2
Economic Development	1,823,969	0.1
Safety & Maintenance of Visitor Facilities	20,279,236	1.2
TOTAL TOT ALLOCATIONS	**66,331,874**	**4.0**
DISC. TRANSFER TO GF	**16,213,238**	**1.0**

** Reflects the net allocation to PETCO Park after applying the $7.5 million repayment from the Redevelopment Agency.*

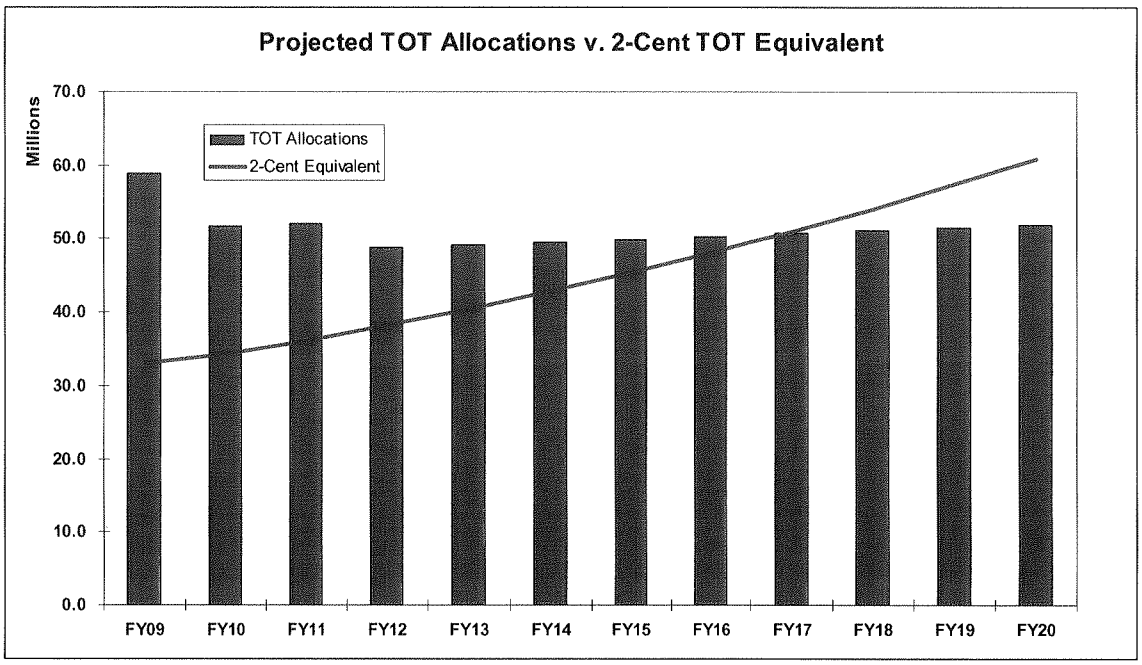
The table above also shows the TOT "cent-equivalent" for each allocation category. The cent-equivalent is calculated by dividing the budgeted allocation by the amount equivalent to 1 cent of TOT, or $16.5 million for FY 2009. For example, $8.1 million is allocated for Arts & Culture programs in FY 2009, which is roughly equivalent to one-half of 1 cent of TOT. It should be noted that the cent-equivalents listed above have no basis in any Municipal Code requirement, but rather are for illustrative purposes only.

From a budgetary standpoint, the main obstacle in implementing Council Member Frye's proposal is that the 4 cents of TOT currently required to be allocated for promotional purposes is already pledged for other purposes. Amending the Municipal Code to require a 1 cent allocation for both Police and Fire would require a commensurate reduction in the allocations to other areas. It should be noted that the FY 2009 allocation for Capital Improvements, which alone are equivalent to 2.2 cents in FY 2009, are largely for debt service payments that cannot be reduced in the near future. The City's TOT-backed debt obligations are shown in the table below.

Debt Obligation	FY 2009 Payment	Final Maturity
City/MTDB Bayside Trolley	$2.9 million	FY 2010
Balboa Park/Mission Bay 1996A	$3.5 million	FY 2011
Balboa Park/Mission Bay 1996B	$0.9 million	FY 2022
Ballpark Refunding Bonds	$11.3 million	FY 2023
City/MTDB Old Town Trolley	$1.2 million	FY 2023
Balboa Park/Mission Bay 2003	$2.2 million	FY 2024
Qualcomm Stadium Bonds	$5.8 million	FY 2027
Convention Center Expansion*	$13.7 million	FY 2028

** The Port District pays $4.5 million of this debt obligation annually*

As TOT revenue continues to grow in the future, and as current allocations are reduced due to the retirement of existing debt, the TOT allocations as proposed by Council Member Frye may become more feasible from a budgetary standpoint. However, as shown in the table above, all but two of the City's TOT-backed backed debt obligations will not mature for many years. The chart below compares projected TOT allocations, adjusted for debt service and certain inflationary factors, with a projected 2 cent TOT equivalent. It should be noted that the projected TOT allocations do not include any allocations to the General Fund for promotion-related expenses, as this strategy would presumably not be necessary under Council Member Frye's proposal.



This table shows that existing TOT allocations will not become equivalent to 2 cents of TOT until approximately FY 2017. In addition, this does not account for any potential increases in TOT funding for Arts & Culture, or allocations to other groups that may apply for TOT funding in the future.

Alternative

A slight modification to Council Member Frye's proposal could remedy this budgetary dilemma, should the Council choose to adopt this plan. Changing the proposed language to indicate that *a minimum* of 2 cents of TOT is required be used for promotion, and that *up to* 1 cent of TOT may be allocated for both Police and Fire facilities and equipment, would allow for continuation or increases to existing allocations, while at the same time allow any excess funding (i.e. below the current 4 cent equivalent) to be allocated for Police and Fire purposes. It should be noted that this alternative would not currently allow for a full 1 cent to be allocated for both Police and Fire unless existing allocations are reduced. However, it would provide the Council with increased flexibility to allocate TOT funds for Police and Fire facilities and equipment.

We also wish to note that prior to publication of this report, a memo was received from Council President Peters that outlined an alternate proposal for amendment to the Municipal Code regarding TOT allocations. The IBA needs additional time to review this alternate proposal, and would be happy to provide further analysis if desired by the Committee.

CONCLUSION

The proposed amendment to the Municipal Code Section 35.0128 regarding TOT allocations, introduced by Council Member Frye on May 1, 2008, would provide significant additional funding to the General Fund for Police and Fire-Rescue facilities and equipment. However, implementation of this proposal would require significant reductions to existing TOT allocations. Since many current TOT allocations are for debt service payments that will not mature for many years, such a reduction in existing TOT obligations may not be possible in the near future. One option would be to modify the proposal such that *a minimum* of 2 cents of TOT is required to be allocated for promotional purposes, while *up to* 1 cent may be allocated for both Police and Fire-Rescue facilities and equipment.

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