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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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**Date Issued:** July 18, 2008

**IBA Report Number:** 08-78

**Budget Committee Date:** July 23, 2008

**Item Number:** 3

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# Council President Peters' Proposed Amendment to Municipal Code Regarding Transient Occupancy Tax Allocations

## OVERVIEW

On June 11, 2008 Council President Peters issued a memorandum proposing an amendment to the Municipal Code regarding the allocation of Transient Occupancy Tax (TOT) revenue. This proposal was made as an alternative to the proposal introduced by Council Member Frye at the May 1, 2008 Budget Review Committee Meeting.

Council President Peters' proposal would amend the Municipal Code to require that 3 cents of the City's 10 ½ cent TOT levy be used solely for the purposes of promotion, while 1 cent be designated for promoting arts and culture. Currently, the Municipal Code requires that 4 cents of TOT be used for the purposes of promotion. While funding for arts and culture is currently provided as a part of this 4 cents, there is no statutory requirement regarding the allocation of the 4 cents for promotion. This proposal would essentially guarantee a specified amount of funding for the promotion of arts and culture.

In FY 2009, this proposal would require that TOT funding be reallocated to arts and culture from other promotion-related obligations, which may be difficult given that a significant portion of existing allocations are for non-discretionary debt service payments. However, growth in TOT revenue and anticipated reductions in certain existing allocations may make this proposal a feasible option in FY 2010.

## FISCAL/POLICY DISCUSSION

At the Budget Review Committee Meeting of May 1, 2008, Council Member Frye introduced a proposal to amend Municipal Code requirements in regard to the allocation of Transient Occupancy Tax (TOT) revenue. This proposal was subsequently analyzed by the IBA in Report No. 08-64 (Attachment A), and presented to the Budget and Finance Committee on June 18, 2008.

An alternative proposal was put forth by Council President Peters in a memorandum dated June 11, 2008. The IBA did not have sufficient time to review this proposal prior to the June 18 Meeting, and the Committee requested that the IBA return with an analysis of Council President Peters' proposal, as well as a historical analysis of TOT allocations. The first section in this report analyzes Council President Peters' proposal, while the second section examines historical TOT allocations and highlights certain prominent trends.

### Council President Peters' Proposal

Municipal Code Section 35.0128 governs the allocation of TOT funds for promotional purposes, requiring that 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 Council.

The proposal from Council President Peters would amend the Municipal Code to reduce the amount of TOT that is required to be used for promotional purposes from 4 cents to 3 cents, and would require that 1 cent be used solely for the purposes of promoting arts and culture. One cent of TOT would remain discretionary under this proposal. These proposed amendments to the Municipal Code are reflected in the table below.

<b>Municipal Code TOT Allocation Requirements, in Cents</b>		
<b><u>ALLOCATION</u></b>	<b><u>CURRENT MUNI CODE</u></b>	<b><u>PETERS PROPOSAL</u></b>
Promotional Purposes	4.0	3.0
Arts & Culture	-	1.0
Council Discretionary	1.0	1.0
<b>TOTAL</b>	<b>5.0</b>	<b>5.0</b>

Currently, funding for arts and culture is considered promotion-related, and is allocated as part of the 4 cent requirement. However, there are no statutory requirements regarding the manner in which the 4 cents for promotion are allocated, and funding amounts for the

various promotion-related categories are largely determined as part of the annual budget process. The proposal from Council President Peters would essentially guarantee that of the 4 cents required to be used for promotion, 1 cent will be used for arts and culture. The following table shows the current FY 2009 Budget allocations, and how the allocations would be impacted under the current proposal.

**Municipal Code TOT Allocation Requirements, FY09 Dollars**

<u>ALLOCATION</u>	<u>FY 2009 BUDGET</u>	<u>PETERS PROPOSAL</u>	<u>CHANGE</u>
Promotional Purposes*	58,061,718	49,433,905	(8,627,813)
Arts & Culture	7,850,155	16,477,968	8,627,813
Council Discretionary**	16,477,968	16,477,968	-
<b>TOTAL</b>	<b>82,389,841</b>	<b>82,389,841</b>	<b>-</b>

\* Reflects non-Arts & Culture promotional allocations, less the Redevelopment repayment (\$7.5m) and Special Event revenue (\$200,000)

\*\* Includes \$220,000 for Mayor and Council TOT Allocations, usually categorized under Arts & Culture funding.

Using FY 2009 dollars, this table shows that under Council President Peters’ proposal approximately \$8.6 million would need to be reallocated to arts and culture from other promotional purposes. This may prove difficult in the current fiscal year, as these monies have already been programmed for other purposes, including debt service payments for TOT-backed debt obligations. The table below shows a more detailed breakdown of these other promotion-related allocations in FY 2009, as well as projected allocations for FY 2010. It should be noted that the figures for FY 2010 are preliminary, and are subject to change.

**Promotion-Related TOT Allocations (Non-Arts & Culture)**

<u>ALLOCATION</u>	<u>FY 2009 BUDGET</u>	<u>CENT- EQV.</u>	<u>FY 2010 PROJECTED</u>	<u>CENT- EQV.</u>
<b>Capital Improvements</b>	<b>36,158,513</b>	<b>2.2</b>	<b>28,680,741</b>	<b>1.7</b>
<i>Balboa/Mission Bay Improvements</i>	<i>6,955,219</i>	<i>0.4</i>	<i>5,573,855</i>	<i>0.3</i>
<i>Convention Center Complex</i>	<i>15,628,553</i>	<i>0.9</i>	<i>10,107,776</i>	<i>0.6</i>
<i>Convention Center Operating Subsidy</i>	<i>4,339,198</i>	<i>0.3</i>	<i>4,339,198</i>	<i>0.3</i>
<i>PETCO Park*</i>	<i>5,227,447</i>	<i>0.3</i>	<i>7,477,629</i>	<i>0.4</i>
<i>Trolley Extension Reserve</i>	<i>4,008,096</i>	<i>0.2</i>	<i>1,182,283</i>	<i>0.1</i>
<b>Economic Development</b>	<b>1,823,969</b>	<b>0.1</b>	<b>1,823,969</b>	<b>0.1</b>
<b>Safety &amp; Maint. of Visitor Facilities</b>	<b>20,279,236</b>	<b>1.2</b>	<b>22,139,420</b>	<b>1.3</b>
<i>QUALCOMM</i>	<i>10,852,504</i>	<i>0.7</i>	<i>12,712,688</i>	<i>0.7</i>
<i>General Fund Promotion-Related</i>	<i>7,455,270</i>	<i>0.5</i>	<i>7,455,270</i>	<i>0.4</i>
<i>Other</i>	<i>1,971,462</i>	<i>0.1</i>	<i>1,971,462</i>	<i>0.1</i>
<b>TOTAL ALLOCATIONS**</b>	<b>58,261,718</b>	<b>3.5</b>	<b>52,644,130</b>	<b>3.0</b>

\* Reflects only the net TOT allocation after the \$7.5 million repayment from the Redevelopment Agency.

\*\* FY 2009 total includes \$200,000 in allocations made from Special Event revenue.

As this table shows, in FY 2009 an equivalent of 3.5 cents of TOT is allocated for non-arts and culture related promotional purposes, greater than the 3 cents proposed by Council President Peters. However, by FY 2010, these allocations may be equivalent to just 3 cents, consistent with the proposal. This is due to regular growth in TOT revenue as well as a few anticipated reductions in current allocations, such as removal of the one-time sewer capacity charge for Convention Center dewatering and retirement of Bayside Trolley debt. Should these allocations materialize as projected, then Council President Peters' proposal may be feasible from a programmatic standpoint in FY 2010, assuming that current funding levels and priorities remain substantially the same.

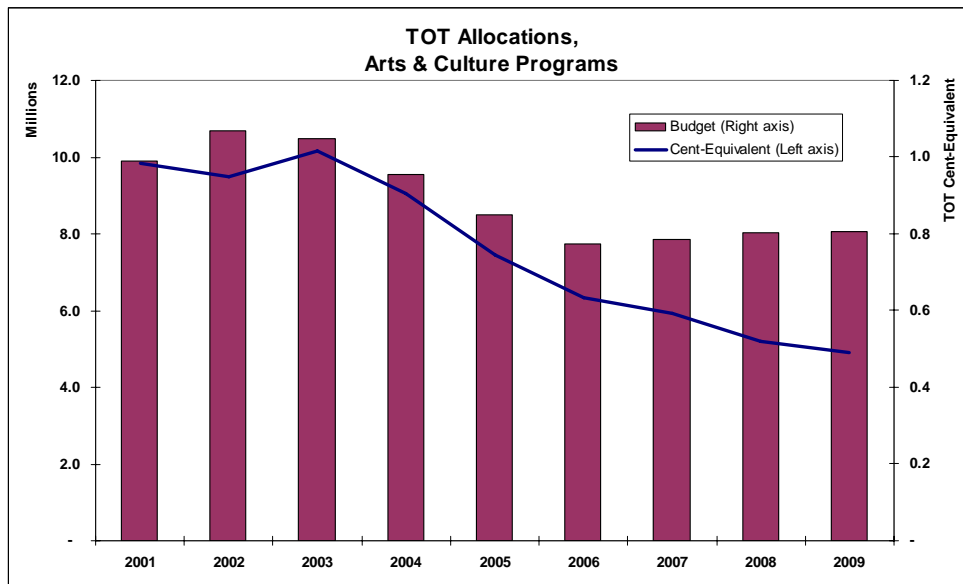
Historical TOT Allocations

Over the past several years, TOT allocations have changed significantly. Some allocations, such as those for Arts & Culture or the San Diego Convention and Visitors Bureau (ConVis), have generally declined due to ongoing budgetary constraints. Other allocations, such as those to PETCO Park and QUALCOMM Stadium, have increased over time as debt service payments and operating expenses have risen. Several prominent allocations have discontinued altogether, such as allocations to the Library System Improvement Fund, and for the groups now funded through the Tourism Marketing District, including ConVis. In FY 2009, TOT was allocated for the first time for specific promotion-related expenses within the General Fund.

Funding sources, too, have changed significantly over time. For many years sales tax revenue was allocated to the TOT Fund in an amount equivalent to 3 ½ cents of TOT to

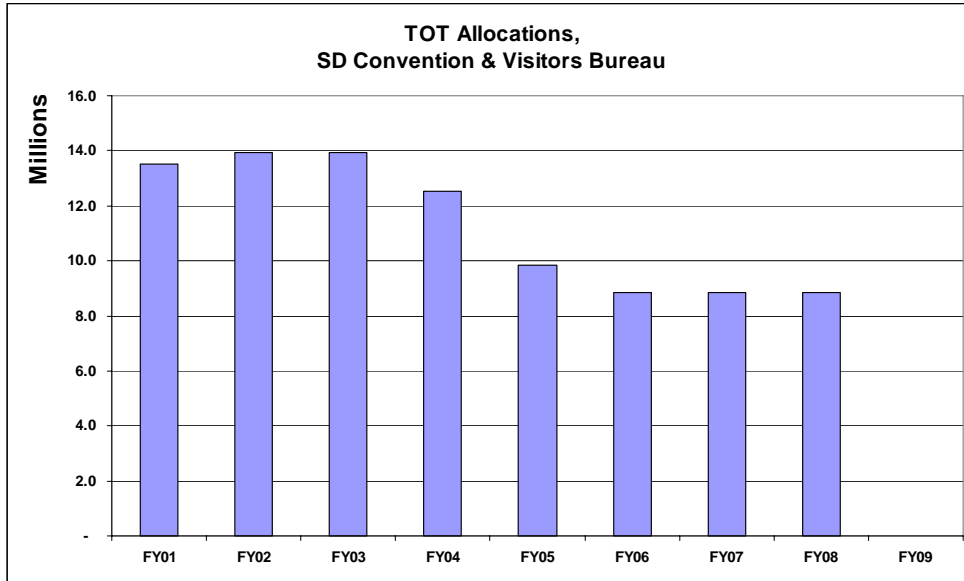
support Special Promotional Program allocations. Excess funding was then transferred back to the General Fund. While this practice was discontinued in FY 2007, General Fund support was still needed in that year to meet existing obligations, though growth in TOT has since relieved the General Fund of any funding obligation. In FY 2009, a \$7.5 million repayment from the Redevelopment Agency was budgeted in the TOT Fund to support PETCO Park debt service payments.

Some of the more prominent trends in TOT allocations since FY 2001 are highlighted in the charts that follow. A more detailed breakdown of all budgeted TOT allocations since FY 2001 is provided in Attachment B. Since Council President Peters’ proposal focuses on dedicating additional funds for arts and culture, the first chart reflects budgeted funding for arts and cultural programs, including Organizational Support, Community Festivals and Celebrations, administration, and funding for other minor categories.

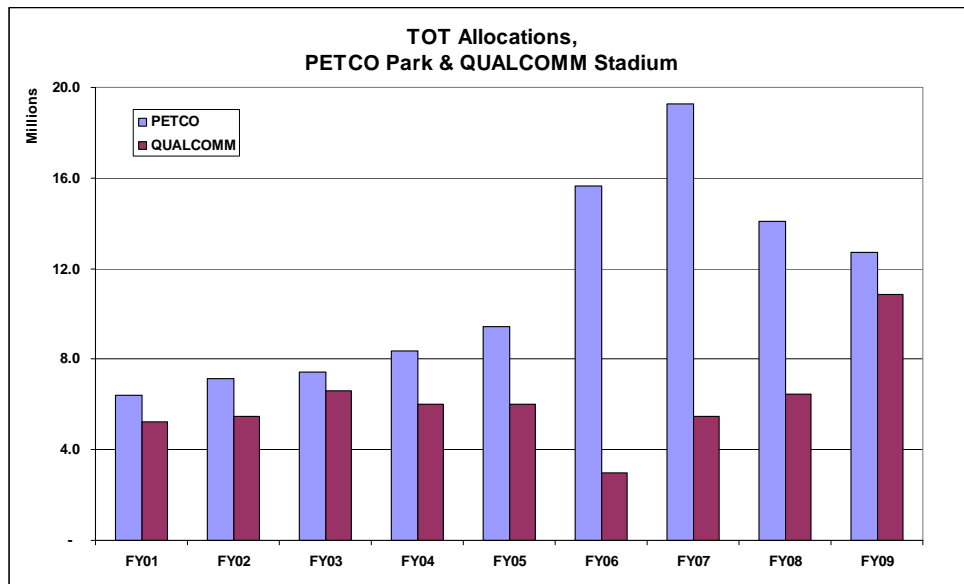


This chart shows that funding for arts and culture declined significantly from FY 2002 to FY 2006, and has increased slightly since. However, to gain another perspective, this chart also shows funding for arts and culture in TOT cent-equivalents, represented by the blue line. This measure shows that arts and culture funding was roughly equivalent to 1 cent of TOT in FY 2003, and has steadily declined to just under ½ cent in FY 2009, despite the slight increase in total funding over the past few years. This means that since FY 2003, arts and culture has received a proportionally smaller share of total TOT allocations.

The next chart reflects TOT funding that was allocated to the ConVis for tourism-related promotion over the same time period.



Like funding for arts and culture, TOT funding for ConVis declined significantly from FY 2003 to FY 2006, but then held constant until FY 2009. In FY 2009, funding was eliminated due to establishment of the TMD, which offsets City funding for ConVis and several other groups.<sup>1</sup> The final chart, shown below, reflects allocations for the City's sports stadiums, PETCO Park and QUALCOMM Stadium.



<sup>1</sup> The TMD technically became effective in January 2008, offsetting half of the FY 2008 allocations to ConVis and other groups. However, the full TOT allocation was initially made in FY 2008, and the City was later reimbursed from TMD assessment revenues.

In contrast to the previous two charts, this chart shows that funding for PETCO and QUALCOMM has generally risen since FY 2001, as debt service payments and operating expenses have continued to increase. Despite a recent decline in the funding allocated to PETCO due to the refunding of the ballpark bonds, the City still allocates significant funding for the two sports stadiums. In FY 2009, approximately \$23.6 million will be allocated for these purposes. It should be noted, however, that the allocation to PETCO in FY 2009 is partially supported through a \$7.5 million repayment from the City's Redevelopment Agency. Despite this, funding needs for both PETCO and QUALCOMM may continue to rise in the future as operating costs increase, unless other sources of revenue or cost savings can be identified.

## CONCLUSION

TOT allocations have undergone significant change over the past several years. While some allocations have increased, such as those to PETCO Park and QUALCOMM Stadium, many have decreased, such as funding for arts and cultural programs. On June 11, 2008, Council President Peters issued a memorandum proposing an amendment to the Municipal Code regarding the allocation of TOT revenues. This proposal would guarantee a minimum of 1 cent of TOT for the promotion of arts and culture, while 3 cents would be used for other promotional purposes. In FY 2009 dollars, this would result in an additional \$8.6 million for arts and culture programs. However, these dollars are already programmed for other promotional purposes, many of which are for non-discretionary debt service payments. However, growth in TOT revenue, combined with anticipated reductions to certain TOT allocations, may make this proposal feasible from a programmatic standpoint in FY 2010, assuming that current funding levels and priorities remain largely the same.

**[SIGNED]**

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**[SIGNED]**

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ATTACHMENT A – IBA Report No. 08-64  
ATTACHMENT B – Historical TOT Allocations