THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: February 19, 2021 **IBA Report Number:** 21-06

City Council Docket Date: February 23, 2021

Item Number: 330

Impacts of Proposed Short-term Residential Occupancy (STRO) Regulations on TOT Revenue

INTRODUCTION

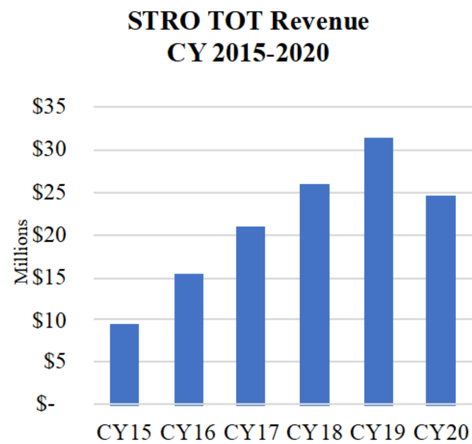
On February 23, 2021, the City Council will consider a proposal by Council President Campbell to regulate short-term vacation rentals, also known as short-term residential occupancy (STRO). A key component of the proposal is the requirement that STRO hosts must apply for one of four different STRO License Tiers, depending on the type and frequency of short-term rental activity. Two of the four STRO License Tiers (Tier 3 and Tier 4 for whole home rentals operating more than 20 days per year in Mission Beach or elsewhere in the City) would be caped under the proposal thereby limiting the number of housing units operating in this capacity. Prepared at the request of Council President Campbell, this report endeavors to quantify the potential fiscal impact the proposed licensing caps would have on City Transient Occupancy Tax (TOT) revenue generated from STRO activity.

It should be noted that there is little publicly available information regarding STRO activity in the City. For purposes of our analysis, we utilized data available from the website *InsideAirbnb.com*, the City Treasurer's Office, past STRO analyses, and other available information; we also had discussions with knowledgeable market participants to provide insight and help us better develop reasonable assumptions to apply to the data we gathered to develop our estimates.

OFFICE OF THE INDEPENDENT BUDGET ANALYST
202 C STREET MS 3A SAN DIEGO, CA 92101
TEL (619) 236-6555 FAX (619)-236-6556

FISCAL/POLICY DISCUSSION

STRO activity has grown significantly over the last several years, much of which can be attributed to online platforms like Airbnb and VRBO which have facilitated an efficient means for both hosts and travelers to connect. According to the City Treasurer's Office (CTO), TOT paid by STRO hosts and online platforms grew from approximately $9.5 million in calendar year 2015 to a high point of $31.5 million in CY 2019. While some of this growth is due to increased TOT auditing activities conducted by the CTO, it nonetheless reflects a significant amount of growth over a short period of time. The COVID-19 pandemic has significantly reduced tourism in the City and brought STRO related TOT revenue down to approximately $24.5 million in CY 2020.



In terms of the number of STRO listings in the City, it has previously been estimated that up to 16,000 STROs were operating as of March 2018. Based on our review of actual listing data available on the website *InsideAirbnb.com* and information on TOT collections provided by the CTO, we estimate that on average there were approximately 19,000 rental listings over the course of the CY 2019 (i.e., the last full year prior to the COVID-19 outbreak). When removing all inactive listings[1], as well that those for which the minimum advertised stay duration is more than one month, we estimate that the average number of active listings that were subject to pay TOT was approximately 14,700. The breakdown of this estimated number of active STRO listings by location and rental type, as well as estimated average rental rates, is provided in the table below.

Based CY 2019 Data using Online Platform Rental Type Classifications	CY 2019 Avg. Listings	% of total Listings by Location	CY2019 Avg. Rental Rates
Mission Beach	1,667	100%	$ 405
Entire Home/Apt	*1,642*	*99%*	*$ 410*
Private Room	*25*	*1%*	*$ 89*
Shared Room	*-*	*0%*	*$ -*
Outside Mission Beach	13,046	100%	$ 209
Entire Home/Apt	*9,660*	*74%*	*$ 254*
Private Room	*3,291*	*25%*	*$ 82*
Shared Room	*96*	*1%*	*$ 56*
Estimated Total	**14,713**	**100%**	

It should be noted that the classifications of rental types included in the table above are from online booking platforms which differ from the proposed STRO regulations.

The proposed STRO regulations require hosts to obtain one of four license tiers depending on the type of short-term rental, the amount of rental activity, and the rental location. These factors are summarized in the matrix on the following page, in addition to the number of licenses which are to be initially allotted for each tier.

[1] Listings were determined to be inactive if they have zero nights available for rent over the next 365 days, or if the host's booking calendar has not had a change over the preceding 12 months.

License	Rental Type	Rentals per CY	Rental Location	# of Licenses
Tier 1	Any	< 20 days	Citywide	Unlimited
Tier 2	Home Share	> 20 Days	Citywide	Unlimited
Tier 3	Whole Home	> 20 Days	Outside Mission Beach	5,364
Tier 4	Whole Home	> 20 Days	Mission Beach	1,081

A **Whole Home** rental is generally defined in the proposed ordinance to be a rental of the host's entire dwelling unit while the host is not present and residing in the dwelling unit. Whole Home rentals of more than 20 days per year outside of Mission Beach would initially be restricted to 5,364 licenses; Whole Home rentals of more than 20 days per year in Mission Beach would be restricted to 1,081 licenses.

Conversely, a **Home Share** is generally defined to be the rental of a room (or rooms) in the host's primary residence, or a separate dwelling unit on the same premises of the host's primary residence (e.g., duplex properties and eligible Companion Units/ADUs), while the host is present. The number of licenses for any type of Home Share would not be limited.

The table below summarizes how listings under each of the rental type classifications used by online booking platforms would be distributed based on the proposed STRO regulations.

Rental Types as Classified by Online Platforms	Rental Types as Categorized by Proposed STRO Regulations	License Tiers
Entire Home/Apt	Any Whole Home < 20 Nights **Whole Home outside of Mission Beach** **Whole Home in Mission Beach** Home Share (e.g., Duplex/ADUs)	Tier 1 **Tier 3** **Tier 4** Tier 1 or Tier 2
Private Room	Home Share	Tier 1 or Tier 2
Shared Room	Home Share	Tier 1 or Tier 2

Quantifying this listing distribution as outlined in the table above, and determining the impact associated with limiting the number of available licenses for the rental types highlighted in bold, constitutes the basis for our analysis.

The most significant unknown variable for purposes of our analysis is the number of Whole Home rentals with less than 20 nights of activity per year. This is meaningful given its direct relationship to the overall impact the proposed STRO regulations will have on TOT (i.e., the larger share this category comprises, the lower the impact to TOT). No online booking platforms have made this information publicly available, nor were we able to find any reliable sources elsewhere. With that said, based on information we have reviewed and discussions with knowledgeable market participants we estimate this rental category to represent approximately 15-25% of the total number of "Entire Home/Apt" listings, as classified by the online booking platforms. Given that there were an estimated 11,302 Entire Home/Apt listings in CY 2019 Citywide, this would result in approximately 1,700-2,800 Whole Home listings with less than 20 nights booked per year.

In the table below, we provide estimates reflecting the distribution of CY 2019 listings based on the proposed STRO regulations. Included are three scenarios, at 15%, 20%, and 25%, for the aforementioned range related to Whole Home rentals with less than 20 nights of activity.

Based CY 2019 Data using Proposed STRO Regulation Categorizations	# of Licenses	*Whole Home < 20 Nights* as a Percent of *"Entire Home/Apt"* 25%	20%	15%
Mission Beach		1,667	1,667	1,667
Whole Home > 20 Nights	***1,081***	***1,131***	***1,213***	***1,295***
Whole Home < 20 Nights	*Unlimited*	*411*	*328*	*246*
Home Share (Duplex/ADU)	*Unlimited*	*101*	*101*	*101*
Home Share (Private Room)	*Unlimited*	*25*	*25*	*25*
Home Share (Shared Room)	*Unlimited*	-	-	-
Outside Mission Beach		13,046	13,046	13,046
Whole Home > 20 Nights	***5,364***	***6,965***	***7,448***	***7,931***
Whole Home < 20 Nights	*Unlimited*	*2,415*	*1,932*	*1,449*
Home Share (Duplex/ADU)	*Unlimited*	*280*	*280*	*280*
Home Share (Private Room)	*Unlimited*	*3,291*	*3,291*	*3,291*
Home Share (Shared Room)	*Unlimited*	*96*	*96*	*96*
Citywide Total		**14,713**	**14,713**	**14,713**

As the assumed number of Whole Home rentals with less than 20 nights (highlighted yellow) decreases, the assumed number of Whole Home rentals with more that 20 nights (in bold) increases, and thus moves from a rental category for which licenses are unlimited, to a category that is limited.

The estimated difference between the number of Whole Home rentals with more than 20 nights and the number of available licenses represents the estimated number of listings that would be lost under the proposed STRO regulations. As you can see in the table below, the estimated number of listings lost ranges between 1,601 and 2,567. This result is then multiplied by our estimate for the average amount of TOT contributed per host which varies given the assumed mix for the number of listings with more or less and 20 nights. The results are shown in the bottom portion of the table below. The associated TOT loss/impact is estimated to range between $4.4 million and $7.3 million, approximately 14% to 23% of the total amount of TOT collected in CY 2019 from STROs ($31.5 million).

Based CY 2019 Data using Proposed STRO Regulation Categorizations	*Whole Home < 20 Nights* as a Percent of *"Entire Home/Apt"* 25%	20%	15%
Mission Beach			
Tier 4 Licenses	*1,081*	*1,081*	*1,081*
Whole Home > 20 Nights	*1,131*	*1,213*	*1,295*
Listings Lost	*(50)*	*(132)*	*(214)*
Estimated TOT Per Host	*$ 8,910*	*$ 8,385*	*$ 7,916*
Estimated TOT Impact	*$ (448,393)*	*$ (1,110,456)*	*$ (1,698,358)*
Outside Mission Beach			
Tier 3 Licenses	*5,364*	*5,364*	*5,364*
Whole Home > 20 Nights	*6,965*	*7,448*	*7,931*
Listings Lost	*(1,601)*	*(2,084)*	*(2,567)*
Estimated TOT Per Host	*$ 2,438*	*$ 2,306*	*$ 2,184*
Estimated TOT Impact	*$ (3,901,642)*	*$ (4,803,281)*	*$ (5,604,521)*
Total Listings Lost	**(1,651)**	**(2,216)**	**(2,781)**
Total TOT Lost ($)	**$ (4,350,034)**	**$ (5,913,737)**	**$ (7,302,879)**
Total TOT Lost (%)	**-14%**	**-19%**	**-23%**

Note: Figures may not sum due to rounding.

Because the proposed STRO regulations limit the number of licenses available for Whole Home rentals (those rented for more than 20 nights a year), we estimate there would be a reduction in TOT ranging from 14% to 23% of the total TOT derived from vacation rentals. If the proposed STRO regulations were to have been in effect in calendar year 2019 (the last full year of activity before the pandemic), we estimate there would have been a reduction in TOT ranging from $4.4 million to $7.3 million. However, when considering the ongoing impacts of the pandemic on tourism and a proposed implementation date in January or February 2022, we estimate the fiscal impact of the proposed STRO regulations on the FY 2022 General Fund budget (which begins on July 1, 2021) would be less than half of this estimated range.

Beginning in FY 2023, we expect tourism to begin approaching normalized levels and estimate that the potential loss of TOT may begin nearing the estimated range above. It should be noted, however, that other factors could increase (e.g., limited growth of new whole home rentals) or decrease (e.g., increased demand for a limited number of whole home rentals drives demand to hotels or otherwise leads to increased rental rates thereby increasing TOT) the estimated range of TOT lost pursuant to adoption of the proposed STRO regulations.

Other Considerations Associated with Proposed Adoption of the STRO Regulations

Our Office estimates adoption of the proposed STRO regulations will annually reduce the amount of TOT revenue the City receives from short-term vacation rentals by approximately 14% to 23%. This is an important consideration given the significant budget deficits projected for the City's General Fund beginning in FY 2022. Having said that, it is important to also acknowledge some fiscal and non-fiscal benefits cited by proponents of the proposal. The Council may wish to consider some of these other potential STRO regulation benefits while evaluating the requested action. Potential benefits include, but may not be limited to, the following:

- Establishes regulations within the San Diego Municipal Code for the longstanding, important and previously unregulated short-term vacation rental industry
- Endeavors to protect the integrity or character of existing neighborhoods
- Plans to establish a host fee to cover the cost of administration and ensure enforcement
- Slows conversion of homes to short-term rentals; returns some to the City's housing stock
- Allows for growth in the number of whole home rental units that is proportionate with the growth in the City's housing stock.

CONCLUSION

Council President Campbell requested that our Office endeavor to estimate the fiscal impact of the City adopting the proposed STRO regulations. Using available data and discussing this data with knowledgeable industry participants, we estimate the potential loss of TOT to be between 14% to 23% of total TOT collected from STROs. In CY 2019, these percentages would have translated to a reduction ranging from $4.4 million to $7.3 million of the total TOT collected from STROs ($31.5 million). However, given the proposed effective date for the proposed STRO regulations (January or February 2022) and the expectation that tourism will continue to trend below normal in FY 2022, we estimate the fiscal impact of the proposed STRO regulations on the FY 2022

General Fund budget (which begins on July 1, 2021) would be less than half of this estimated range – something less than $2.2 million to $3.6 million. The full impact of our estimate would more likely be realized in FY 2023 or FY 2024 when there is an expectation that tourism will return to pre-pandemic levels.

We also note that there are a number of factors that could increase or decrease our estimated range of TOT lost pursuant to the adoption of the proposed STRO regulations. For example, restricting the growth of new whole home rentals could increase the estimated amount of TOT lost going forward. Another possibility is that increased demand for a limited number of whole home rentals could redirect demand toward hotels or otherwise lead to increased whole home rental rates which would reduce the estimated loss of TOT to the City.

It is particularly difficult to sustain a loss of General Fund revenue when budget deficits are projected in the coming fiscal years. Having said that, we note the magnitude of the proposed TOT revenue loss would likely be less than one-half of 1% of total General Fund revenue. We also must acknowledge the potential legal and policy benefits associated with the proposed STRO regulations. We have highlighted five of the key benefits cited by the proponents in the preceding section for Council consideration.

Baku Patel
Fiscal & Policy Analyst

Jeff Kawar
Deputy Director

APPROVED: Andrea Tevlin
Independent Budget Analyst