



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Tourism Marketing District District Management Plan

OVERVIEW

The current five-year San Diego Tourism Marketing District (TMD), which began January 1, 2008, is set to expire on December 31, 2012. As an initial step in preparation for the District's renewal, on September 13, 2011, the Procedural Ordinance establishing the process for forming and renewing a TMD was amended by the City Council. The amendments extend the maximum term of a TMD from 10 years to 40 years, ensure the adherence of TMD assessments with Proposition 26, and establish actions to determine the validity of and for contesting the validity of a district. In following the renewal procedures outlined in the Procedural Ordinance, on September 25, 2012, the City Council will consider the approval of the TMD District Management Plan (Plan). The Plan proposes the boundaries of the new District, the number of years for which assessments are to be levied, sets forth changes in assessments for the years of the operation of the District, and expands the number of businesses to be assessed. It also details administrative and operational guidelines for the TMD, including fundable activities and budgeting guidelines for the district.

In addition to considering the approval of the District Management Plan, it is requested that the City Council adopt the Resolution of Intention to renew the TMD which declares the intent to levy assessments for the 39.5 year term of the District, notices the dates for a public meeting and public hearing, and directs that ballots are sent to businesses for indication of support or opposition to the assessment as proposed. As planned, on October 23, 2012, public testimony will be taken regarding the establishment of the District. On November 26, 2012, the proposed public hearing date, public testimony will be taken, ballots counted, and in the absence of a majority protest, the adoption of a Resolution of Formation, and the authorization of an operating agreement between the City and the TMD Corporation. The Operating Agreement will further detail the administrative and operational guidelines for the TMD Corporation.

As was recommended in IBA Report 11-48, and directed by the City Council at the August 2011 Council hearing regarding the adoption of the TMD Procedural Ordinance, the District Management Plan was presented at an October 2011 Budget & Finance Committee meeting where the Committee had an opportunity to provide input on the Plan before affected businesses were petitioned. With feedback from the Committee and IBA at the October Committee meeting, and additional modifications to address Proposition 26 considerations, the Plan draft underwent numerous revisions. A revised draft of the Plan was presented at the July 25, 2012 Budget & Finance Committee meeting. The current Plan reflects modifications to address a request by the Committee to add language regarding Brown Act compliance and clarifying language to address Committee questions. With the final revisions to the District Management Plan, lodging businesses were petitioned over the summer, concluding with the submission of petitions to the City, and verification that support for the District represented 50% of the annual assessment from businesses.

In its current form, the District Management Plan is substantially different from the original 2007 District Management Plan providing guidelines for the expiring TMD. Major changes include the proposed term of the district, the levied assessments, participating businesses, defined eligible funding activities, and budget guidelines. The following serves to highlight the major changes from the current TMD District Management Plan to the proposed District Management Plan, and also provides additional information for City Council consideration.

FISCAL/POLICY DISCUSSION

Assessed Businesses

The 2007 District Management Plan identifies assessed businesses as lodging businesses of 70 or more sleeping rooms within the City of San Diego, exempting businesses that do not currently collect transient occupancy taxes. With the new Plan, all lodging establishments within the City will be part of the renewed TMD (with the exclusion of single room occupancies and businesses that do not currently collect transient occupancy taxes). The inclusion of all lodging businesses within the City is an effort to identify all businesses that will benefit from the marketing, sales, and promotional activities that generate incremental room night sales, with incremental room night sales being the specific benefit experienced by those businesses assessed. The inclusion of lodging establishments of 69 rooms and below will equate to an additional \$1.4 million in revenue to the renewed TMD, for a total estimated revenue generation of \$30.0 million annually. The total number of lodging businesses will expand from 176 in the current District to 1,379 in the renewed District.

Benefit Categories

The District Management Plan establishes two benefit categories for the new District: Categories A & B. Businesses in Category A are businesses within the District with 30 or more rooms. Businesses in Category B are all businesses within the District. The primary distinction between the benefit categories are that Category A provides *direct* marketing, sales, and promotions, with Category B providing *general* marketing, sales, and promotions. Category A businesses will benefit from meeting & group direct sales, consumer direct sales & marketing programs, and multi-year tourism development; with Category B businesses benefiting from destination marketing with a call to action specifically related to lodging businesses within the District.

Within the District Management Plan, comprehensive descriptions are provided for each of the benefit categories, and in the case of Category A, three sub-categories A1, A2, A3, to clearly delineate the specific benefit conveyed, to an extent that was not present in the 2007 District Management Plan. The addition of this detail to the Plan is an effort to assure the adherence of TMD assessments with Proposition 26. The new benefit categories clarify the direct, exclusive benefit to the assessed lodging businesses. Fees or charges relating to a direct benefit conveyed are exempt from the limitations of Proposition 26, and are therefore not to be considered a special tax requiring approval by 2/3rds of voters in the general public.

Assessments Levied

Lodging businesses in Benefit Category A will be assessed at a rate of 1.45%, with businesses in Category B being assessed at a rate of 0.55%. All lodging businesses with 30 or more rooms will fall within both Categories A & B, thus paying a total assessment of 2.0%. Lodging businesses with 30 rooms or less will pay a 0.55% assessment. According to the TMD Corporation, the determination of the 1.45% and .55% assessment for each of the benefit categories was derived from an analysis of the TMDs historical funding patterns for the past five years. Funding for destination marketing with a specific call to action in Category B generally comprised a certain percentage of funding activity, with Category A activities (meeting & group sales, consumer direct marketing, sub-regional targeting, and competitive targeting) comprising a certain percentage. With consideration of administrative and reserve expenditures for both categories, the assessment structure of 1.45/.55% would collect an amount proportional to historical expenditures in those benefit categories, with approximately 72.5% being related to Category A and 27.5% being related to Category B.

Benefit Category	Assessment	Lodging Businesses
A	1.45%	30 or more rooms
B	0.55%	All

Term of District

On September 13, 2011, amendments to the TMD Procedural Ordinance were approved by City Council, modifying the 10 year term for the existence of a TMD to up to a 40 year term. The purpose of the amendment as proposed was intended to address the need to support long-term planning by the TMD. This is particularly the case with the anticipated expansion of the San Diego Convention Center. With current plans for the industry to support a long-term bond obligation to finance the expansion, the industry desires to ensure that complimentary marketing investments will be existent through the term of the industry’s financial obligation. With a 40 year term, the TMD would be able to engage in long-term marketing commitments to boost industry performance over the life of the bonds.

Per Civitas Advisors, Inc., an industry expert in improvement district formations, and the author of the new District Management Plan, a 39.5 year term would be the longest term for a tourism marketing district of any city in the state of California at this time. Currently there are 68 tourism marketing districts within the state. Of these established districts, districts with longer terms are Anaheim’s, with a 30 year term, and the San Francisco district, with a 15 year term. Also per Civitas, approximately half of other districts within the state are either approved annually, or for up to five years upon formation, with up to 10 years with renewal. Below you will find comparative information regarding the annual budget, assessment rates, approval year, district terms, number of hotels, and the transient occupancy tax rate for select cities locally and within the State of California.

District	Annual Budget	Assessment	Approval Year	Term	Number of Hotels	TOT
Anaheim/Garden Grove	\$ 9,000,000	2% of gross room rental revenue	2010	30 year	84	15.00%
Carlsbad	\$ 874,000	\$1.00 per occupied room per night	2005	Annual	40	10.00%
Chula Vista	\$ 650,000	2.5% of gross room rental revenue	2009	Five year formation; Up to 10 year renewal	23	10.00%
Coronado	\$ 500,000	0.5% of gross room rental revenue	2010	Annual	4	8.00%
Fresno	\$ 800,000	1.0% of gross room rental revenue	2010	Five year formation; Up to 10 year renewal	87	12.00%
Long Beach	\$ 3,000,000	3.0% of gross room rental revenue	2005	Annual	16	12.00%
Los Angeles	\$11,500,000	1.5% of gross room rental revenue	2011	Five year formation; Up to 10 year renewal	165	14.00%
Oceanside	\$ 472,500	1.5% of gross room rental revenue	2010	Five year formation; Up to 10 year renewal	18	10.00%
Palm Springs	\$ 5,500,000	2% of gross room rental revenue	2008	Annual	na	12.70%
Sacramento	\$ 5,200,000	1-3% of gross room rental revenue	2012	Five year formation; Up to 10 year renewal	114	12.00%
San Diego (Proposed)	\$30,000,000	2% of gross room rental revenue	2007	39.5 year	1,379	10.50%
San Francisco	\$27,000,000	.75%-1.5% of gross room rental revenue	2008	15 year	na	14.00%
San Jose	\$ 1,500,000	\$.75-\$2.00 per occupied room per night	2006	Annual	72	10.00%

Source: Civitas Advisors, Inc. as of July 6, 2012

Fundable Activities

All TMD funding recipients are required to have funding sources, aside from the TMD. The District Management Plan states that: *“To the extent that other, non-District, lodging businesses receive any incremental room nights, that portion of the promotion or program generating those room nights shall be paid with non-district funds.”* This requirement provides further assurance that the specific benefit of the District is not experienced by non-District lodging businesses, in adherence with Proposition 26.

The Plan also differs from the 2007 Plan, in adding *“political candidate or ballot initiative activity”* to the listing of activities that cannot be funded using TMD revenue. This language was added as a result of a Committee request for its addition during the October 2011 Budget & Finance Committee meeting to ensure that TMD revenue could not be used for these purposes.

Also of note, Section I of the District Management Plan states that no bonds shall be issued by the TMD. This language was added to assure consistency with Section 61.2506(c)(1) of the Procedural Ordinance that notes that the Resolution of Intention for the TMD must include a statement that bonds will not be issued by the District. It is important to note that although no bonds can be issued by the District, this language does not specifically exclude the use of TMD assessments for the payment of debt service. This is particularly relevant given a March 16, 2012 letter from the Board of Directors of the TMD to the City Council pledging TMD revenues from the renewed District to limit the City's annual contribution to debt service on the proposed Convention Center expansion project to \$3.5 million.

Although the Plan does not specifically include language that TMD funds can be used for this purpose, Section II.C. of the Plan does stipulate that "*the acquisition, construction, installation or maintenance of any tangible public property...*" cannot be funded by the District. This language is consistent with the 2007 District Management Plan. At the publication of this report our office has not been able to confirm whether TMD revenue can be used to support debt service on a public facility such as the proposed Convention Center expansion. The Council may wish to request further guidance regarding this matter from the City Attorney's Office.

Budget Guidelines

Within the new District Management Plan, the budget guidelines for the TMD have changed substantially from that of the 2007 Plan. The TMD Corporation has communicated that although the funding allocations have changed, the proportion of funding allocated to specific activities will be consistent with historical allocations, while allowing for flexibility.

Of notable difference, in the 2007 Plan, the funding allocations were as follows: 50% to the San Diego Convention Visitors Bureau (CVB), 10% for the previous North CVB, 5% to the Marketing Opportunity/Catastrophe Reserve Fund, and 3% for operating expenses, with the remaining 32% of revenue allocated in the competitive funding process. With the new District, 90% of TMD revenue will be designated for marketing and sales activities, with 10% designated annually for administration and the Reserve. A minimum of 3%, and maximum of 7% of TMD revenue can be budgeted for administrative costs and the Reserve. A budget of more than 5% of TMD revenue for either administration or the Reserve would require a 2/3rds vote of the Board of Directors. Every fifth fiscal year an additional 0.5% will be allocated to the administrative cost allocation to fund the District Milestone Report. Litigation costs are not included in the administrative costs limit. It is anticipated that litigation expenses would be supported by the Reserve. If for any reason litigation expenses exceed budgeted amounts within the Reserve, a budget adjustment may have to be approved by the Board of Directors and the City Council.

A more detailed budget will be presented as a part of the annual Report of Activities that will be developed and approved by the TMD Board of Directors and City Council. It's important to note that, after the formation of a renewed District, in early 2013, the TMD Corporation will have to request approval of the TMD budget for the remaining months of FY 2013. As was presented to the City Council in May 2012, the 2013 Report of Activities only included funding for half the year for District activities (July 1-December 31st) due to the anticipated expiration of the current district, and the ongoing renewal process.

The chart below compares the current and proposed TMD budget guidelines.

Expenditure	2007 Plan	Proposed Plan
San Diego CVB/DMO	50%	90%
North San Diego CVB/DMO	10%	
Competitive Targeting	32%	
Marketing Opportunity/Catastrophe Reserve	5%	3-7% } 10% Total
Administration	3%	3-7% }

The 2007 District Management Plan specifically identifies the CVB and the previous North CVB as the recipient a total of 60% of TMD allocations to sell, market, and promote lodging businesses, in addition to providing destination marketing. The 2007 Plan included draft MOUs between the District and the CVBs discussing details regarding funding and performance expectations. The new Plan does not specifically identify the CVB as the Destination Marketing Organization (DMO) that will provide a large percentage of the marketing services in Benefit Categories A & B. It is of our office’s understanding that the contracting process for a DMO will be detailed in the Operating Agreement between the City and the TMD Corporation. This agreement will come before Council for approval on November 26, 2012. As in previous years, the CVB can also compete for competitive funding, purposed to fund special programs, activities, events, and services that are typically awarded to smaller service providers.

Council Oversight

Once the District Management Plan is adopted, and the District is established by City Council resolution, any future changes to the Plan must be initiated by the TMD Corporation. Our office recommends that the Council requests further guidance from the City Attorney’s Office regarding the modifications that can be made to the Plan at the September 25, 2012 hearing, as well as at the November 26, 2012 public hearing, and the procedural requirements for such changes, if any, in accordance with the TMD Procedural Ordinance.

Other opportunities for Council input on administrative and operational guidelines for the TMD will arise when the contract between the City and the TMD Corporation is considered for approval on November 26, 2012. The 2007 Plan stipulates that any modifications to the District Operating Agreement, once adopted, have to be initiated by the TMD Corporation. The current Plan stipulates modifications are to be mutually agreed upon by the City and the Corporation as stipulated in the approved agreement.

Consistent with the original District Management Plan, the current Plan requires an annual Report of Activities to the City Council that will include, among other things, the budget for the next year, any proposed changes to district boundaries, and the method and basis for assessments. Given the proposed term for the renewed District, a District Milestone Report will be presented to Council every five years, including the information contained in an annual Report of Activities, in addition to reporting on activities from the previous five year interval, and plans for the next five years. The Council can approve the reports, or modify them, and approve them as modified. The Plan does stipulate that *“the Council shall not approve a change in the basis and method of levying assessments that would impair a contractual obligation of the City Council or approved by the City Council”*. Also, changes to the Report of Activities that

would require modifications to the District Management Plan would have to be initiated by the TMD Corporation and meet notice and protest requirements outlined in the Procedural Ordinance.

Disestablishment procedures

Section 61.2524 of the TMD Procedural Ordinance outlines the process for the disestablishment of the TMD. The City Council can disestablish the district by resolution: *“If the City Council finds there has been misappropriation of funds, malfeasance, or violation of law in connection with the management of the district”*. Assessed business owners have the annual opportunity to request disestablishment of the District during a 30-day period after the presentation of the District’s Report of Activities. Disestablishment would require that businesses representing more than 50% of district assessments petition for disestablishment and the adoption of a resolution of intention to disestablish the District by the City Council, with public hearing requirements.

CONCLUSION

On September 25, 2012, the City Council will consider the approval of the TMD District Management Plan. The Plan will propose the boundaries of the new district, the number of years for which assessments are to be levied, set forth changes in assessments for the years of the operation of the district, and expand the number of businesses to be assessed. It will also detail administrative and operational guidelines for the TMD, including fundable activities and budgeting guidelines for the District. In addition to considering the approval of the District Management Plan, it is requested that the City Council adopt the Resolution of Intention to renew the TMD which declares the intent to levy assessments for the 39.5 year term of the District, notices the dates for a public meeting and public hearing, and directs that ballots are sent to businesses for indication of support or opposition to the assessment as proposed.

This report serves to highlight the major changes between the current TMD District Management Plan and the proposed District Management Plan, and provides additional information for City Council consideration. There are areas where the IBA recommends the City Council request further clarification before adoption of the District Management Plan and Resolution of Intention. We recommend that the City Council requests from the City Attorney’s Office further clarification regarding:

- Whether TMD assessment revenues can be used to support debt service on non-TMD issued bonds
- Guidance on the modifications that the Council can make to the District Management Plan before the Resolution of Intention and the Resolution of Formation for the District are separately adopted


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