TOURISM ECONOMICS

The Impact of Reduced Funding for the San Diego Tourism Marketing District

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AN OXFORD ECONOMICS COMPANY

Contents

1 Executive Summary

Funds intended for the San Diego Tourism Marketing District (SDTMD) have been significantly withheld since January 1, 2013. The SDTMD budget ranged from $21 million to $27 million in recent fiscal years. SDTMD funding in the second half of fiscal 2013 was reduced to 61% of normal funding, and just 16% of normal funding levels in FY 2014. The reduced funding in FY 2013 has resulted in the reduction and/or elimination of sales and marketing campaigns designed to encourage visitation to San Diego. This report quantifies the impact of reduced marketing funds on the hotel industry in terms of lost room revenues and room nights that have already occurred, and those impacts expected through the end of December 2014.

Over the course of FY 2013 and FY 2014, a total of $30 million will not be spent on marketing activities that would be spent under normal funding conditions. The negative impacts of this reduction have been evident in the recent performance of the San Diego hotel industry. The lack of sales and marketing has played a role in the city's trailing performance versus other regional and national destinations that have continued to market their destinations. Room demand cooled off in San Diego in 2013, and occupancy rates and prices have increased at a slower rate than in competing markets. The total amount of losses experienced by San Diego's hotel sector over 2013 and 2014 is expected to tally more than $200 million in room revenues and 1.2 million room nights for the County. The City of San Diego would realize losses of 859,000 room nights and $162 million in room revenue and a reduction in TOT collections of $17 million over this two year period. These estimates were reached through two independent calculations; a market share analysis and econometric modeling.

These figures only measure the impact on the hotel sector. The total impact on the San Diego regional economy extends to the retail, restaurant, entertainment and transportation sectors. Losses are projected to include visitor spending of $560 million, reduced countywide tax revenues of $24.3 million, and total reduced business sales in the San Diego regional economy of $1.3 billion (including indirect and induced impacts).

This analysis assumes that reduced sales and marketing funding is temporary and that funding is restored in mid-2014. It is important to note that even after funding is restored, the impacts of reduced marketing expenditures are likely to persist for at least several quarters. As visitors, business groups and event planners need some lead time, re-building the pipeline of future events and visitors will not happen immediately. Therefore, the estimated impacts reported here, for 2013 and 2014, are likely lower than what the actual impacts will turn out to be if a longer time horizon were to be considered.

The analysis is organized as follows:

- Section 2 compares the San Diego hotel industry's recent performance with regional and national competitor destinations. In this section, losses are estimated by assuming San Diego's hotel sector would have maintained market share if funding were sustained as opposed to losing market share as has been the case through September of 2013. Assuming that San Diego would have maintained its market share from the end of 2012, then taking the differential versus what has actually happened in 2013, provides an estimate of lost room revenues. This analysis is projected to the end of 2014.

- Section 3 presents the results of econometric modeling that compares two scenarios. The first scenario is the current Tourism Economics forecast for San Diego hotel performance based on recent trends and the assumption that reduced funding continues through the end of FY 2014. The second scenario (a counterfactual) predicts what would have happened in the event that funding was sustained through 2013 and 2014 by beginning the forecast period in January 2013 while using current economic drivers. Again, the difference between the counterfactual and actual scenarios provides an estimate of losses to the hotel sector.
- Section 4 examines the total economic impact, recognizing that the impact of reduced visitation extends beyond the hotel sector.
- Section 5 provides an overview of the San Diego econometric forecast model.

2 Market share calculation of losses

Key findings:

- San Diego's hotel sector has lost ground to both regional and national competitors in 2013.
- Room demand and revenue growth slowed in 2013. Both occupancy rate and prices have trailed other markets.
- Based on a calculation of market share losses, reduced marketing funding has cost the San Diego metro area hotel sector $63 million in room revenues in 2013.
- Across all of 2013 and 2014, San Diego is expected to forfeit $208 million in countywide hotel room revenue on the basis of market share losses.

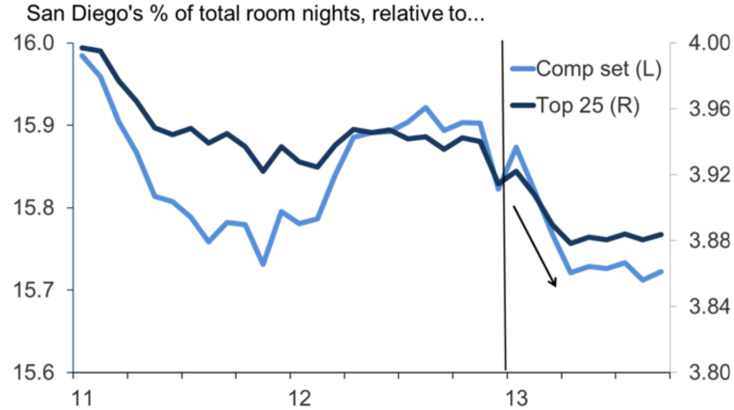
2.1 Losing market share

San Diego County was the 10th largest market in US in 2012 as measured by total room nights. With nearly 15 million room nights, San Diego accounted for 3.9% of room demand among the top 25 US destinations. Other destinations that make up San Diego's regional competitive set include Los Angeles, San Francisco, Anaheim, Phoenix and Seattle. San Diego held a nearly 16% market share among this competitive set of destinations.

Competition to attract visitors is intense and most destinations dedicate resources for destination marketing and promotion. Destinations that do not engage in marketing risk losing market share. The impact of significantly reduced destination marketing for San Diego has already become apparent from a market share perspective. Among the top 25 US markets, San Diego's market share fell from 3.9% at the end of 2012 to 3.8% as of September 2013. Relative to the more specific set of five peer competitors, the County's market share fell from 15.9% at the end of 2012 to 15.7% as of September 2013.

Declining Market Share in Volume

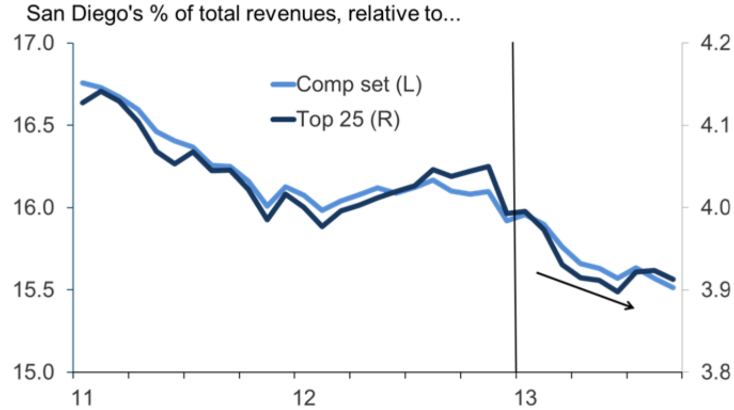
San Diego's % of total room nights, relative to...



Sources: STR, Tourism Economics

Declining Market Share of Revenues

San Diego's % of total revenues, relative to...



Sources: STR, Tourism Economics

Even small changes in market share translate into significant numbers in terms of room demand and revenues. Assuming market share would have remained the same in 2013 as it was at the end of 2012, with San Diego matching growth at the national level, the lower share cost the San Diego metro area as much as 450,000 room nights in demand and more than $60 million in room revenues just in the first nine months of 2013.

Current available data cover through September of 2013, and anecdotal reports indicate that conditions in the hotel sector in the beginning of the off season months, October and November, have not improved. In addition, looking beyond 2013, the impact of the lack of marketing and advertising will continue into 2014, *even if funding is restored immediately*, as it takes time to ramp up operations and travelers and meeting planners require lead time to plan trips and events.

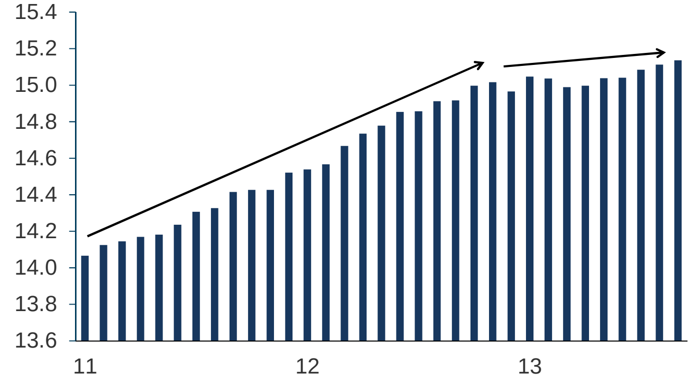
Tourism Economics' current forecasts for San Diego and the top 25 US markets provides a baseline for revenue losses still to come. The scenario is compared to a scenario in which San Diego holds its market share versus the top 25 competitor markets through 2014, implying higher greater room demand and revenue. Considering the differentials in revenue growth through September plus the expected losses through 2014, San Diego's losses would total $208 million in room revenues for the County and $155 million for the City of San Diego over this two year period.

2.2 Demand slowed markedly

The driving force behind the loss of market share has been the leveling off of San Diego room demand in 2013, while demand growth in other destinations continued at a stronger pace. In January of 2011, room demand tracked at a pace of 14 million room nights and increased to roughly 14.5 million room nights by 2012. At the end of

Demand Leveled Off in 2013...

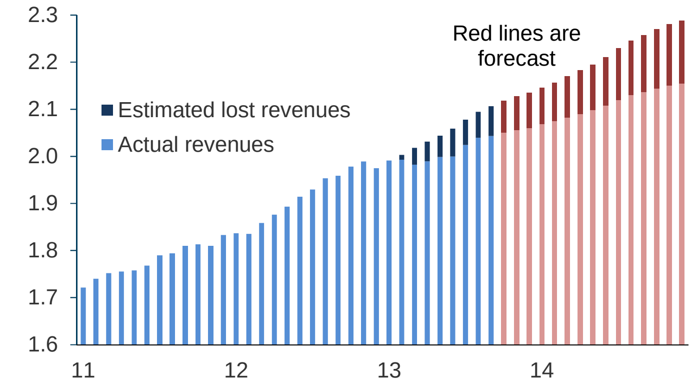
Room nights, millions, 12-month rolling sum



Sources: STR, Tourism Economics

...and Weighs on Revenues

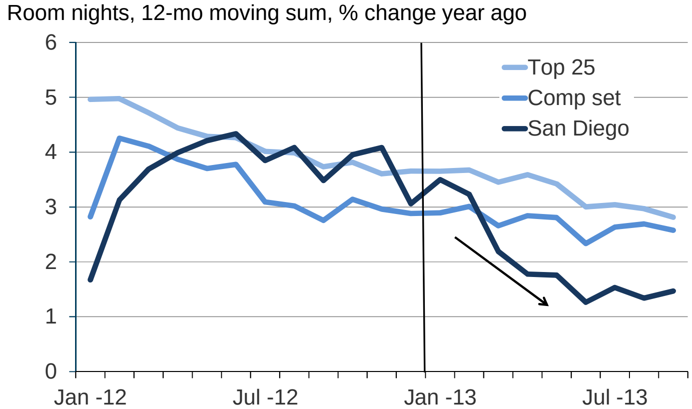
Room revenues, $ billions, 12-month rolling sum



Sources: STR, Tourism Economics

Slower Demand Growth

Room nights, 12-mo moving sum, % change year ago



Sources: STR, Tourism Economics

2012, the pace of demand had increased to nearly 15 million room nights for the County and 10.8 million for the City. Through the first nine months of 2013, the pace of room demand in the metro area has stagnated, growing just 1.5% over the same period last year. This compares to growth of more than 3% in 2012.

Growth in room demand in competing regional destinations and the US also moderated in 2013, but to a much lesser degree than in San Diego.

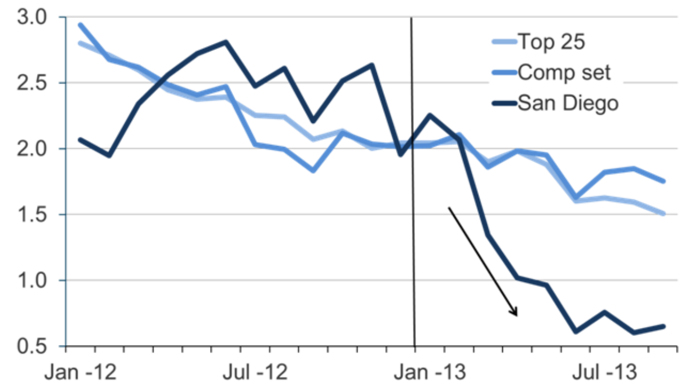
2.3 Softness in occupancy and prices

Softness in the San Diego Market is also evident in price and occupancy figures. Occupancy has ticked up in 2013, but at a slower pace than in other destinations. Occupancy increased in most other markets, driven by improvements in broader economic conditions and the resulting boost in travel. San Diego however, benefited from these improved conditions to a lesser degree. In the San Diego metro market, hotel occupancy was 0.7 percentage points above the year ago level in September 2013. Increases were greater in other markets; as much as 7 percentage points in Denver, 3 percentage points in Phoenix, and 1 percentage point in San Francisco.

Changes in prices were also weaker in San Diego compared with other markets, as price is driven by occupancy rates and the *change* in occupancy, or the degree of tightening in the market. At the end of 2012 price growth was tracking above 5% versus year ago levels, but this slowed significantly to less than 3% by September of 2013. Growth in prices remained stable in regional competitors and in the broader market, trending between 4.5% and 5.5%.

Change in Occupancy Slower in San Diego

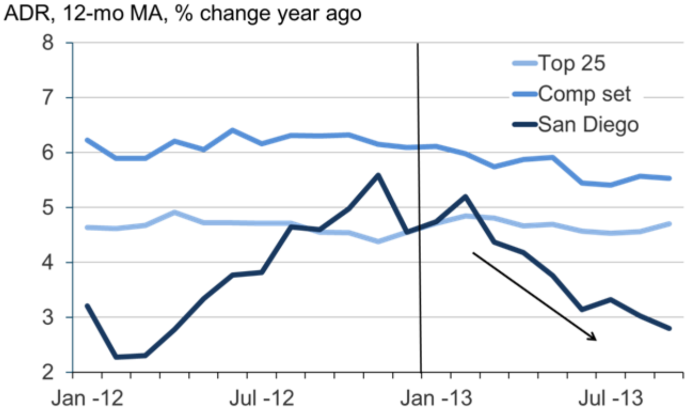
Change in occupancy rate, percentage points



Sources: STR, Tourism Economics

Price Growth is Slower

ADR, 12-mo MA, % change year ago



Sources: STR, Tourism Economics

3 Econometric Calculation of Losses

Key findings

- Econometric modeling indicates that San Diego metro area hotels will lose $223 million over 2013 and 2014 as a result of reduced destination promotion. San Diego City hotels will lose $166 million.
- Over the two-year period, the total reduction of demand will amount to 1.2 million room nights for the County and 859,000 room nights for the City of San Diego.
- Average prices (ADR) will end up lower by $7.94 per room night.
- Impacts from defunding were felt immediately in 2013 and will likely continue even after funding is restored, assumed in this analysis to be in mid-2014.

3.1 Counterfactual analysis

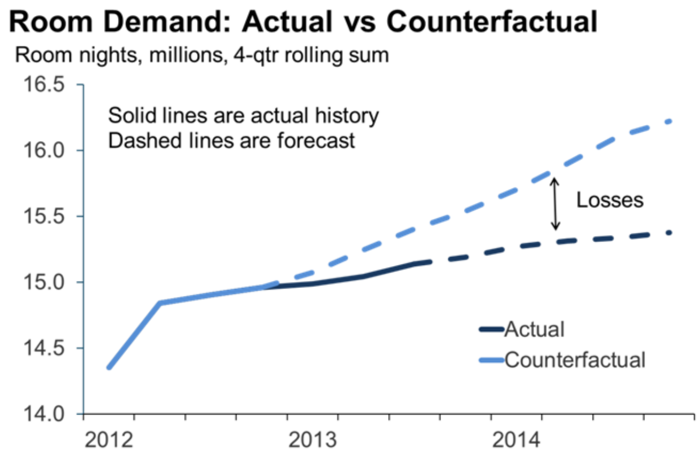
The econometric approach of the analysis is based on a counterfactual scenario. Counterfactual analysis allows for a “what if” scenario by comparing what would have happened (the counterfactual) versus what has happened or is expected to happen (the actual), all else being equal. The counterfactual scenario considers actual history through the end of 2012 and then creates a forecast starting in 2013 and assumes normal marketing conditions. The actual forecast includes all available historic data through September of 2013, and forecasts from that point forward. Losses are calculated as the difference between the counterfactual and actual scenarios. Both models include forecasts of key hotel sector metrics such as room supply, room night demand and ADR. And both models include the latest economic data and forecasts for the US and San Diego’s key visitor markets.

3.2 Assumptions and the channels of impact

The lack of funding of SDTMD beginning in early 2013 had immediate impacts on visitation to San Diego and is also likely to have future impacts even after the restoration of funding. The absence of direct marketing to leisure consumers likely had an immediate effect as ad buying in the spring cycle can influence spring break (leisure) travel late in the first quarter. Impacts would deepen not only for the leisure segment but also for the group business segment over time. As the pipeline of group business booked in previous periods is consumed, reduction in the group sales force weakens the future pipeline. Assuming funding is restored along with the sales force, the pipeline of group sales would begin to expand, however the expansion would be further along in the pipeline as the bulk of group business in the short term would already be booked in competing destinations. Thus, there is a lag in the recovery of the group business segment which extends beyond the point when funding is restored. For this reason, the counterfactual analysis assesses losses through the end of 2014 even though funding is assumed to be restored in mid-2014.

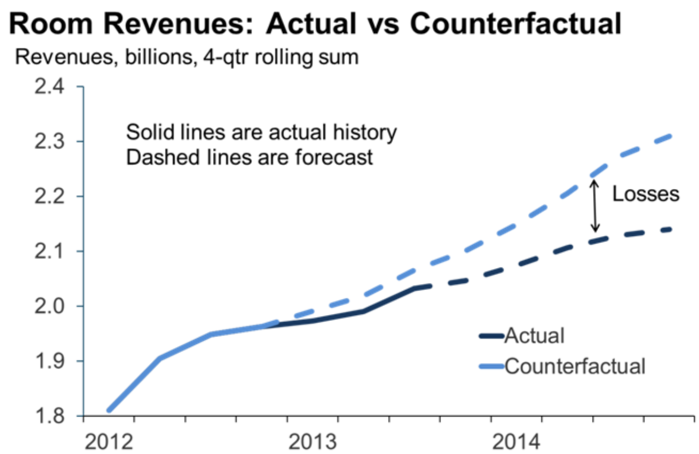
3.3 Analytical results

The baseline scenario includes actual historical data through 2013Q3 and makes forecasts from 2013Q4 through 2014Q4. The baseline model indicates an increase of 1.5% in room night demand in 2013 from 2012 levels (an increase of approximately 231,000 room nights countywide) with ADR rising 2.7% to $134.75 for 2013. The baseline model forecasts an increase of 186,000 room nights sold (1.2%) in 2014. These figures imply an increase of hotel revenue of 4.3% and 4.5% in 2013 and 2014 respectively, for a total increase in metro area hotel revenue of $177.2 million over the two years combined. Given the room supply and pipeline, revenue per available room (RevPAR) would increase 3.4% in 2013 and 3.0% in 2014, reaching $98.48 in 2014.



Sources: STR, Tourism Economics

The counterfactual scenario uses historical data through the end of 2012 and generates forecasts starting in 2013. Using the same economic drivers as in the baseline model, the counterfactual model suggests countywide room demand would have increased 3.9% (580,000 room nights) in 2013 and 4.4% in 2014 (682,000 room nights). ADR would have increased to $135.21 (3.1%) in 2013 yielding and increase of $138.3 million (7.0%) in hotel revenue and RevPAR of $98.34 (6.3%). In 2014, ADR is forecast to rise to $142.34 (5.3%) in the counterfactual scenario. This would yield and increase of $208.0 million (9.9%) in metro area hotel revenue and RevPAR of $106.42 (8.2%) for 2014 versus 2013.



Sources: STR, Tourism Economics

The estimated losses incurred by San Diego hotels are the difference between the counterfactual and the actual (baseline) scenarios. Over the two calendar years of 2013 and 2014, hotels would have collected an additional $223.3 million in revenue. The impacts on revenue have been affected by both a decrease in demand (1.2 million room nights over the two years) and lower ADR ($7.94 less in the baseline versus counterfactual models in 2014).

The results for San Diego County are shown below. City of San Diego results are derived based on the City's share of County room nights and room revenue, respectively.

Model Results: Impact of Reduced Funding	2013				2014						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2013	2014	2-year Sum
Actual											
Room demand (thousand)	3,537	3,911	4,352	3,389	3,615	3,957	4,374	3,429	15,189	15,375	30,564
ADR ($)	126.85	133.29	150.85	124.01	131.74	139.86	155.09	125.89	134.75	139.17	136.973
Total room revenues ($ million)	448.6	521.3	656.5	420.2	476.3	553.4	678.4	431.7	2,046.7	2,139.7	4,186.5
RevPAR ($)	85.74	97.90	121.25	77.47	89.65	102.37	123.43	78.30	95.59	96.57	97.01
Counterfactual											
Room demand (thousand)	3,620	4,032	4,416	3,470	3,781	4,233	4,620	3,586	15,538	16,221	31,759
ADR ($)	129.03	131.76	149.80	127.08	135.97	139.08	157.52	133.37	135.21	142.34	138.853
Total room revenues ($ million)	467.2	531.2	661.5	441.0	514.2	588.7	727.7	478.3	2,100.9	2,308.9	4,409.8
RevPAR ($)	89.35	100.12	122.38	81.31	96.85	109.30	132.63	86.75	98.29	100.16	102.33
Total losses (difference)											
Room demand (thousand)	83.7	120.4	63.5	81.7	166.2	276.3	245.7	157.2	349.2	845.4	1,194.6
ADR ($)	2.2	-1.5	-1.0	3.1	4.2	-0.8	2.4	7.5	155.11	200.09	186.944
Total room revenues ($ million)	18.5	9.9	5.0	20.8	37.9	35.3	49.3	46.6	54.17	169.16	223.33
RevPAR ($)	3.60	2.21	1.13	3.84	7.20	6.92	9.20	8.45	2.70	3.60	5.32

4 Total economic losses

Key findings:

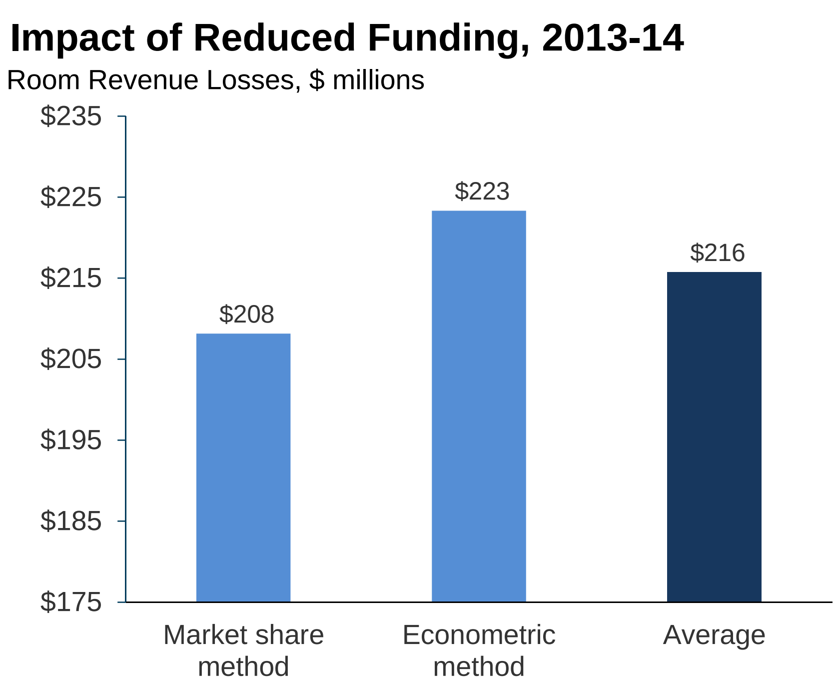
- Based on current policy, TMD is set to experience a total loss of destination marketing funding of $30 million over FY 2013 and FY2014.
- Taking the midpoint of the estimates generated by the two approaches described in Sections 2 and 3 equates to $216 million in lost room revenues for the County and $161 million for the City of San Diego.
- The economic impact of reduced marketing expenditures will extend beyond the hotel sector through lower visitation and visitor spending.
- The total economic impact in San Diego County would amount to $1.3 billion in lost business sales.

4.1 Expected hotel room revenue losses

The two methods employed to estimate hotel room revenue losses associated with reduced destination marketing produce very similar results.

The market share analysis indicates that San Diego County will forfeit $208 million in room revenues over the course of 2013 and 2014. The econometric model predicts a loss of $223 million.

The analysis of full economic losses uses the average of these two estimates: $216 million over the course of 2013 and 2014.



4.2 Impacts on the rest of the San Diego County economy

These figures only measure the impact on the hotel sector. The total impact on the San Diego economy extends to the retail, restaurant, entertainment and transportation sectors. This loss of visitor spending represents the direct impact across the San Diego economy.

Losses also include indirect (supply chain) and induced (income effect) impacts. Indirect impacts result from supply chain demand reductions. For example, lower restaurant spending would result in losses to industries that supply the restaurants, such as the food wholesalers. Induced effects are realized as household income is reduced and resident spending along with it. The direct effect plus the indirect and induced effects combined make up the total economic impact.

4.3 Total impact

Total Fiscal & Economic Impact 2013-14 ($ Millions)		
Lost room revenues (county)	$	215.7
San Diego City	$	161.8
Total visitor spending (county)	$	560.4
Total San Diego County tax revenues	$	24.3
TOT tax revenues	$	22.2
Sales tax revenues	$	2.1
Total San Diego City tax revenues	$	18.6
TOT tax revenues	$	17.0
Sales tax revenues	$	1.6
Total business sales and income (direct, indirect, induced)	**$**	**1,266.5**

Previous TMD research was used to establish relationships between lodging spending, total direct visitor spending, and total spending in the economy.[1] Based on reduced room revenues of $216 million, it is estimated that a total of $560 million in visitor spending will be lost in the San Diego economy as a result of the lower levels of marketing expenditures. This assumes lodging spending accounts for 38.5% of total visitor spending. Based on this estimate of total lost visitor spending over 2013 and 2014, an estimated $22.2 million in TOT revenues and $2.1 million in sales tax is expected to be lost countywide over the same time period. This amounts to a total of $24.3 million in lost countywide fiscal revenues. The City of San Diego is expected to lose about $17 million in TOT and $1.6 million sales tax revenue. The total expected loss for the City of San Diego would be about $18.6 million. The broader impact on the regional economy is estimated at almost $1.3 billion in foregone business sales. This incorporates an estimated multiplier of 1.26 generated from previous economic impact modeling for San Diego's visitor economy.

These estimates of the total economic impact are reasonable order of magnitude estimates, but as with any forecast are surrounded by uncertainty and actual impacts could vary depending on several factors. The degrees to which hotel prices respond to changing conditions in demand are uncertain, which means price could be higher or lower than those incorporated into this analysis, and this would impact the estimate of total revenues. Therefore the total amount of lost visitor spending could be higher or lower than estimates reported here.

[1] CIC research was reviewed and provided the lodging share of total visitor spending, and tax revenues and total business sales generated per dollar of visitor spending.

5 Overview of San Diego Econometric Model

Forecasts reported in this document represent the baseline outlook with a business as usual marketing effort with scenarios of reduced marketing. This does not take any specific marketing programs directed at key markets into account.

The forecasts are primarily based upon expected economic developments in key origin markets as well as anticipated costs. Previous tourism trends relative to economic demand and travel conditions have been tracked and relationships have been quantified. Estimated relationships are applied to the economic and broader tourism forecasts.

Forecasts do account for the impact of important events which would influence visits and/or spend, such as air service restrictions and special events in San Diego such as hosting the Superbowl or US Open.

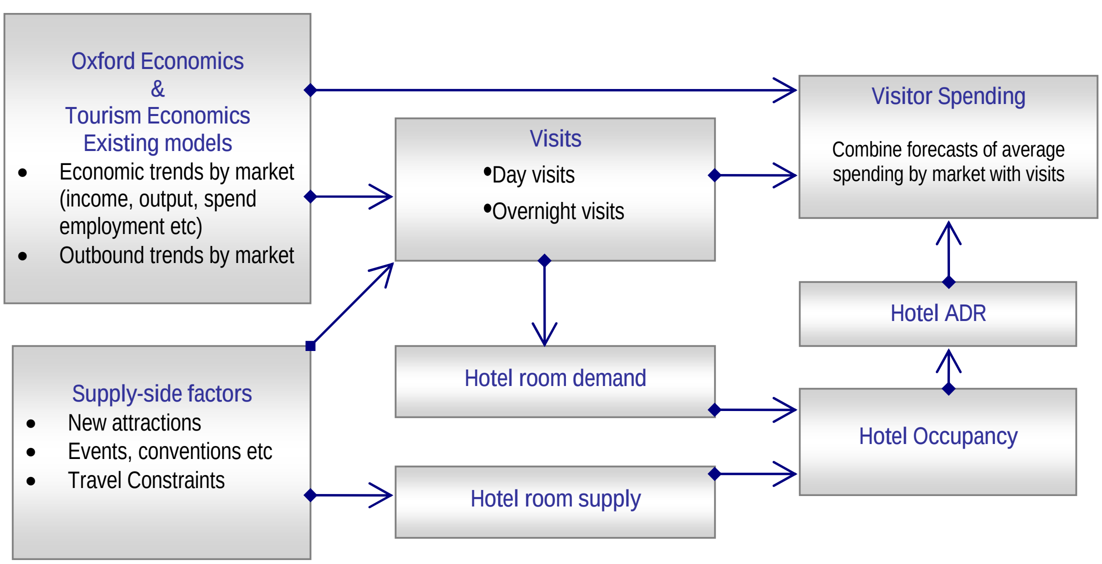
Summary of Main Model Relationships

- Overnight Visitors. Trends in overnight visits have been identified and are forecast separately for stays in hotels and in private households. Forecasts account for different trends according to purpose of visit (business and leisure) as well as by origin market. Economic developments in key origin markets at the city, state, national and international level are included.
- Day Visitors. Travel patterns from nearby drive markets tend to differ from those from longer-haul markets. For day visitors the impact of economic developments in key origin markets and tourism costs (such as hotel room rates) differs from the impact on overnight visits. Mexican visitors represent a significant proportion of day visitors to San Diego and trends have been separately identified. For non-Mexican day visitors, business and leisure trends have again been separately identified taking developments in origin markets into account.
- Visitor Days. Visitor days spent in San Diego are calculated from the number of overnight visits multiplied by average length of stay, plus day visits. Differences in the average length of visit according to origin markets are taken into consideration as well as any impact of economic developments.
- Visitor Spending. Average spending per day is calculated for different market segments and applied to visitor days. This takes tourism-related price inflation in both San Diego into account (such as hotel room rates), as well as spending patterns according to origin market and the impact of more general tourism costs (such as airfares and fuel costs).
- Hotel Rooms sold. Hotel room demand largely follows the trend in overnight visitor days. The impact of local demand on rooms is also

accounted for as locals tend to use more rooms in economic downturns as a replacement for longer-haul travel.

- Hotel Rooms supply. Supply is calculated as the current stock of hotel rooms plus planned and current hotel construction. Probabilities are applied to the current timetable of projects underway to determine when new capacity will be available. It is assumed that almost all hotels under construction are completed, while a smaller proportion of those in the planning stage are completed according to plan.
- Hotel Occupancy. Occupancy is simply determined as the ratio of room demand to supply in terms of room nights.
- Hotel Average Daily Rate (ADR). The cycle in daily rates follows occupancy closely, with a slight lag. Over time, more general price inflation also needs to be taken into consideration and price developments in San Diego as well as in origin markets are important factors.

Summary of Main Model Relationships



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