

There are some very ambitious items on the priority list that the City Council is discussing at its Strategic Planning Session this year. I suggest the City Council add an item for discussion at the January 19 Strategic Planning Session - under the category of “How are we going to pay for all the stuff we want to do?”

Is this the year that Laguna Beach confronts and addresses its biggest financial challenge?

Visitor impacts are both **physical** and **fiscal**. We are all well aware of the **physical** impact of millions of annual visitors to Laguna – traffic, congestion, parking issues, and sometimes worse impacts. The **fiscal** impacts are not as obvious but are equally detrimental to the residents. A large share of the taxes paid by residents is not used to pay for services or capital improvements that directly benefit residents, but are instead diverted to cover the substantial costs the city incurs due to the high number of visitors to Laguna. Indeed, it could be concluded that the residents are not getting what we are paying for because the residents are covering costs that should instead be covered by the visitors creating those costs.

A study in 2017 revealed that in fiscal year 2017-2018, with a city budget of \$93.7 million, **the revenue the city received that was attributable to tourists was \$23.1 million less than the added costs the city incurred due those visitors.**

Since that time the city budget has grown from \$93.7 million to over \$137.2 million, and the number of visitors has also grown. Thus, the costs of providing essential services due to visitors has grown, and the imbalance between revenue attributable to visitors and costs attributable to visitors also is likely to be much greater than \$23 million.

The city leaders and city staff have acknowledged the problem identified by the study, and some early efforts were made to come up with ways to close the gap, but there has been little progress in reducing this deep subsidy by residents of visitors.

There are various reasons why the costs from visitors vastly outweigh the revenue the visitors create for the city government. For a town with our population, Laguna receives a very high number of calls for public safety services. This means Laguna needs many more public safety employees than would be normal for a city with our population. One study indicated that Laguna has roughly three times the number of public safety employees of other cities in California with populations similar to Laguna but with few tourists. Three times the number of public service employees means the cost to the city of providing acceptable response times and service levels is triple what it would be for other similar size cities. Public safety employees are very important but very expensive. Never-the-less, we do not want to compromise public safety for cost reasons.

The increased costs due to visitors are not limited to public safety costs. Added costs ripple through the Public Works and Utilities Department, Transit and Community Services Department, and most aspects of city government.

It is time to act. Some solutions will likely require a ballot measure while others will only require Council to act decisively. The City Council can put a measure on the November 2024 ballot which enables the citizens to vote on a measure that will narrow the gap between revenue and costs associated with visitors. This is especially important because the current City Council's priorities include a number of items that will require a lot of revenue. Moving forward on some of these priorities makes it even more

important to reduce the subsidy to visitors. A list of some of the current City Council's Policy Initiative and Larger Projects is attached to the end of this note.

If even a few of the larger projects being considered come to fruition, the aggregate cost to the city could exceed hundreds of millions of dollars. Without correcting the drain on city revenue due to visitor costs, it will be financially challenging for the city to proceed with even the most important projects.

There are ways to generate more revenue from visitors. And it is fair to do so. There is no good reason that visitors should not be responsible for covering the costs they create for the residents.

The key alternatives to a ballot measure to increase revenue the city receives from visitors are to either raise taxes on residents, lower the level of city services provided by the city government, or borrow a lot of money.

How can we reduce this imbalance in costs?

We cannot put up toll booths, but we could look at the following potential sources.

Parking Charges

Though we should look at parking charges, raising parking charges alone will not come close to solving the problem. Besides, parking charges are limited by the Coastal Commission. However, there is value in looking into a program of expanding pay parking for nonresidents to areas throughout the city that are within walking distance of the beaches while allowing residents to continue to park for free in residential neighborhoods,

Hotel Tax

Laguna's hotel tax should be reviewed. Laguna already has a hotel tax that is paid by visitors to Laguna's hotels. And, in 2016, Laguna voters passed by a large margin Measure LL, an additional hotel tax. Laguna hotel taxes are currently at a combined total of 12% - plus 2% for the voluntary Laguna Beach Tourist Marketing Tax which supports the visitor bureau plus a number of non-profits. But roughly one third of the hotel rooms in Orange County are subject to city hotel taxes of 15% plus the additional voluntary 2% tax. As a top Orange County visitor destination, it seems only fair that Laguna's total hotel tax should be in line with other top Orange County tourist destinations. Bringing the total hotel tax to be on par with the Orange County hotels charging 15% could generate over \$5 million in additional annual revenue based on the current city budget. While a revised hotel tax would contribute to correcting the imbalance, that alone would still leave Laguna far short of closing the gap between visitor related revenue and visitor related costs.

Business License fees

We could adjust the city's business license fees. In fact, the biggest potential impact on revenue designed to cover visitor costs could come from a revised business license fee focused on tourist-focused businesses. Laguna's 140 bars and restaurants could be the stars in this effort. The 2020 Retail Market Evaluation prepared for the city showed how linked to and dependent on visitors Laguna's restaurants are. A business license fee based on 1% of the gross revenue of these restaurants could currently generate over \$4 million per year for the city government and a very high proportion of this city revenue would come from visitors patronizing these restaurants.

With inflation and the growth of the city budget, the gap between costs and revenue related to visitors might have grown to more than \$30 million. So, a visitor-targeted business license fee that slowly

increases from 1% to a maximum of 5% over the course of 5 years could eventually cover perhaps 60% of the current imbalance.

The 2016 Visitor Profile and Economic Impact Study done for Visit Laguna reported that while only a small percentage of visitors stay in Laguna hotels and pay hotel tax, approximately 70% of visitors to Laguna do spend on food and beverages in town. So, Laguna's tourist focused restaurants represent a point of contact between most visitors and local businesses and an opportunity to create a collection mechanism for visitor revenue to cover visitor costs.

Those businesses with the greatest interface with visitors could be key to the solution. They could act as Laguna's toll booth taking a very small percentage of what they are paid by customers and passing that along to the city in the form of a business license fee based on the gross revenue from the business.

If the goal is to get visitors to pay their costs, the solution is not to raise sales taxes because Laguna residents pay a large share of the sales tax collected by Laguna Beach. But an adjusted business license fee that is manifested in small increases in the price of items on the menu could raise funds for the city while closely targeting the source of funds to be only purchases from the most visitor focused businesses.

Not all businesses would face such an increase in business license fees. If the voters would agree by passing a ballot measure to do so, **the city could adjust the city business license fees charged to the businesses who are the most tourist focused.** The businesses that are primarily resident serving and not primarily tourist focused could have little or no change in the business license fees they are charged. And, to protect smaller businesses, the fees to the larger tourist focused businesses could be higher than the business license fees for the smaller businesses. Laguna's existing business license fees are already structured so that different types of business and different sizes of business pay different fees. That license fee structure simply needs to be adjusted to accomplish the goal of collecting more revenue from visitors to cover the costs related to those visitors.

Would this be an undesirable burden on these tourist-serving businesses? In fact, surveys indicate that **Laguna Beach currently ranks among the lowest cost cities in California for business license fees.** Average Laguna Beach fees are currently only about 22% of the state median Business License fee. Clearly, there is substantial room for Laguna to adjust this fee without being out of line. And few California cities are as impacted by visitors as is Laguna, so a well-targeted fee that brings the revenue from visitors closer to covering the costs attributable to visitors is well justified.

Combining an increased hotel tax and the redesigned business license fee could, in time, cover more than 75% of the overall shortage, thereby reducing the subsidy of residents to visitors, leaving more city revenue available to serve residents, and freeing up funds for the many projects on the city council priority list.

This is an election year. Now is the time for the City Council to act to close this huge financial gap and reduce the subsidy of visitors by residents. A solution will likely require a ballot measure. And a plan and ballot measure will take time to develop. Now is the time to get started, and it is the City Council that needs to take the action to do that.

Attachment

As referenced above, the following is a list of some of the current Policy Initiative and Larger Projects being considered by the City Council:

- Potential Laguna Canyon Road Acquisition, Improvements, and Utility Undergrounding
- Possible Coast Highway Acquisition from Caltrans
- Promenade on Forest
- Downtown Action Plan
- Senior/Affordable Housing Program
- Parking/Mobility Master Plan
- Fire Station Four construction
- Fire Station One repairs or possible replacement
- Involvement in LAUSD Proposed Community Pool
- Potential LBCRC (formerly St. Catherines) programs and capital investments
- Extension of City Transit Services
- Parks and Recreation Master Plan projects