



Considerations about Increasing TOT in 5th District, Sonoma County
 Potential Economic Impacts
 January 12, 2021

Executive Summary

By increasing the TOT rate in the defined area, policy makers are assuming demand is set to rise from 2019 levels. We use an average of \$200 per night annually and 74-percent occupancy to calculate comparison data. The key is how consumer respond to rising costs as a result of the tax rate increase. If demand is stable or contracts from 2019 levels as a baseline, the following effects are estimated to take place in the defined area and also spill over into Sonoma County overall:

- Hotel revenues fall;
- Job losses take place and other business' revenues fall;
- Tax revenues from other transactions fall from levels sustained before the tax increase;
- The defined area gains more tax revenues, where the net gain or loss to Sonoma County depends on how the quantity of hotel rooms demand changes based on the price increase;
- One of three general scenarios are estimated to take place:
 - If the quantity demand rises beyond 2019 levels, all parties gain;
 - If the quantity demand falls less than 4.1% for each percentage increase in consumer cost of staying overnight, hoteliers lose, there are negative economic impacts, and there is a net gain in tax revenues;
 - If quantity demand falls more than 4.1% for each percentage increase in consumer cost, there is a net loss to government revenue, shifting tax gains to the new TOT rate from other tax revenues countywide.

If occupancy rates rise allowing the TOT to be passed on completely at \$200 per night (demand rising at all prices), the TOT increase is between \$725,000 and \$1.13 million per year.

If occupancy rates do not rise and remain stable such that \$200 per night is possible for all properties on average annually, the following data summarize the potential changes to the county economy under different price-responsiveness scenarios at \$200 per night (best case without rising demand).

	Price Response Scenarios		
	Less Responsive	More Responsive	Large Response
New TOT Revenues moving from 12% to 16%	\$2,963,376	\$2,731,856	\$1,296,496
Business Revenues	(\$2,805,552)	(\$5,143,513)	(\$19,638,866)
Jobs	-22.9	-42	-160.2
Tax Revenues	(\$187,943)	(\$344,563)	(\$1,315,603)
Net Tax Revenues	\$2,775,433	\$2,387,293	(\$19,107)



Overview

There is a ballot measure for voters on the March 2021 ballot in a portion of Sonoma County's 5th supervisorial district. The measure is asking to increase the current transient occupancy tax (TOT) rate by 4 percent specific to assessed properties in the unincorporated school districts (the defined area) of this supervisorial district. The market for overnight stays would change as a result of the tax increase due to rising costs for overnight customers and hoteliers would receive less overall revenue than before the tax change. If demand to stay at these properties rises regardless of price over time (Revenues on overnight stays rise to new levels for all properties due to a general rise in demand), owner revenues may grow even with rising tax rates; if revenues do not rise above pre-tax levels, existing properties have less revenue after the tax increase, creating negative economic impacts on the 5th district and Sonoma County overall. This brief study also shows the connections between hotels and the rest of the Sonoma County economy, or the economic impact of changing revenues.

The key is how consumer demand responds to rising costs; this is measured in the number of rooms occupied. The consumer's response helps determine the portion of the new tax rate hoteliers can pass on to consumers. Competition both inside and outside Sonoma County, as well as general perceptions of staying overnight in the defined area affect the consumer response. Hoteliers (including owners of short-term stay properties) have fewer rooms demanded and less revenues unless: (1) 100 percent of the new tax can be passed on to overnight guests; or (2) demand rises to higher levels than before the tax. What has happened during COVID-19 and also recent fire episodes show how sensitive markets can be.

The more consumers respond to rising costs, the lower number of hotel rooms they consume, reducing the amount of business revenue retained by hoteliers. The smaller the response by customers to higher prices based on the TOT hike, the more revenue hoteliers retain after the tax. Consumer may go to other areas that are close to the local area where the after-tax cost is lower, or not come to the area at all. Relatively-high TOT rate areas speculate that customers are relatively insensitive to price or that demand is rising regardless of price. The TOT is similar to a sales tax, as TOT is assessed per dollar spent. For example, when you pay \$100 per night to stay in a hotel room, at TOT rate of 10 percent means you will pay \$10 of tax or have a total cost of \$110. TOT is also a regressive tax such that lower-income groups pay a higher percentage of their income than higher-income groups when paying TOT.

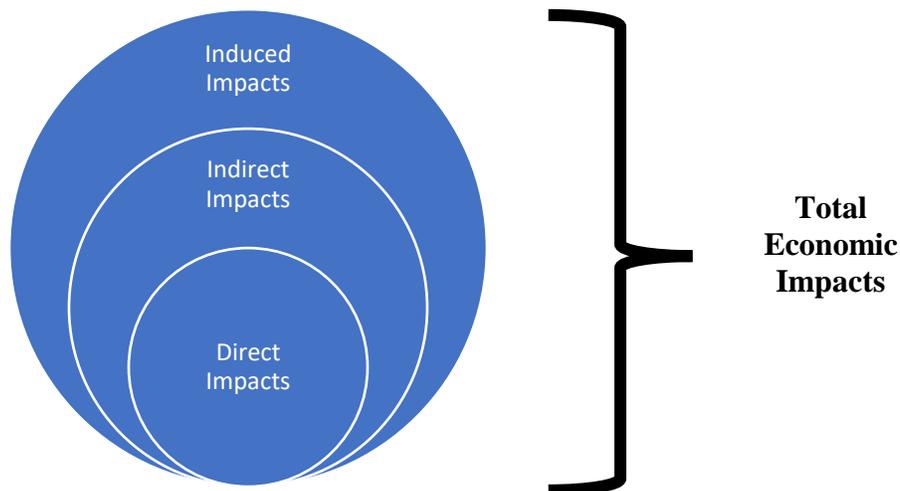
Assuming stable demand, revenue falls for hoteliers due to the TOT rate increase, leaving hoteliers with less to spend on their workers and vendors. Economic impacts then take place because:

- Hotel revenue falls due to higher costs to consumers; then
- Hoteliers cut back on staff to save costs; and
- Hoteliers reduce their vendor contracts to save costs.

Basic Economic Impact Idea

Figure 2 shows the ripples out into the defined area and ultimately Sonoma County more broadly.

Figure 2: Economic Impact Idea



This process is negative in its impacts when business revenues fall due if losses come from a rising TOT rate. The lost hotel-room occupancy reduces the capacity to support jobs and vendor incomes, generating broader economic losses. If occupancy rates are not rising on average per year, current hoteliers and county government have the following effects from the rising tax rates:

- Property owners lose revenue from the pre-tax level;
- The number of rooms occupied per year fall as costs to consumers rise;
- Local government gains from the pre-tax revenue levels due to the higher tax rate, even if there is a lower volume of overnight stays from the pre-tax situation; and
- The more responsive consumers are to cost changes, property owners lose more.

For the economic impact analysis, the **Direct** impacts are hotel revenue losses. **Indirect** effects come from hotel workers and businesses decreasing their spending on local businesses due to lower revenues or lost jobs at hotels, motels and short-term rentals. For example, when a gardening service is hired less than previously due to occupancy rates falling, this business hires fewer worker hours and purchases fewer pieces of equipment, less fuel, and then other local businesses lose revenue. Such additional rounds of jobs and revenue losses create **induced** effects from the indirect effects. With fewer jobs and revenues at hotels and local vendors, there is a decrease in demand for an array of other industries throughout the defined area, as the worker that lost her job at the gardening service lowers her spending on a broad range of goods and services. Other tax revenues that come from



broader economic activity (sales taxes and property taxes for example) also grow at a slower pace as an opportunity cost of the lower amount of economic activity. This is a threat to county tax revenues overall: the net gain from the TOT rate rising is nullified by less tax revenue elsewhere, a concern that spills out into other areas of Sonoma County based on the rising tax area's economic connections to the broader county economy.

Basic Data and Scenarios

Using 2019 data (considering those data “normal” versus the 2020 anomaly of COVID-19 effects on the travel market, more on this effect per the travel forecast below), we use an average daily rate (ADR) of \$200 per night on average for all properties (including discounts and promotional pricing), 365 days per year, with approximately 1,500 rooms available daily in the defined area. We use an occupancy rate of 74 percent as annual average. The steps to understand the change in overnight stay businesses revenues as a result of the increasing TOT rate are as follows:

- The assumed ADR (\$200 per night on average) and occupancy rate (74 percent) are used to calculate:
 - the revenue per available room;
 - the TOT revenue based on those sales at 12% TOT; and
 - the total revenue in the market for the defined area based on 1,500 rooms available annually on average in the defined area;
- Using a TOT of 16%, the steps are:
 - Calculate the % change in price = 3.57%
 - Use three different consumer responses to changing price on the number of overnight stays;
 - There are three scenarios of total room revenue;
 - There are three scenarios of new TOT revenue; and
 - There are three scenarios of lost business-owner revenue as a result of the lower quantity demand of rooms per year, assuming demand is stable otherwise;
- Using the lost business-owner revenue, the IMPLAN[®] model then allows a calculation of:
 - Lost business revenues for those businesses connected to overnight stay businesses as vendors, spending lost by workers in hospitality and other industries that lose their jobs; and broader effects on spending;
 - Lost jobs; and
 - Lost tax revenues otherwise due to fewer transactions and property purchases because of the contracting business revenues and jobs and wages; and
 - Gains in TOT revenue for the defined area with the rising TOT rate.

Figure 3 provide estimates of gains and losses due to the rising tax rate, with the net gains to Sonoma County that come from lost tax revenues otherwise offset by the TOT gains. It is important to recognize that if the rising TOT creates lost business revenues from the status quo, there are lost jobs and fewer tax revenues available otherwise in Sonoma County that help pay for public resources in the defined area.



Figure 3: Estimates Under Different Price Response Scenarios

	Price Response Scenarios		
	Less Responsive	More Responsive	Large Response
ADR	\$200	\$200	\$200
Cost to Consumer at 12% TOT	\$224	\$224	\$224
Rooms/stays sold at 12% TOT	405,150	405,150	405,150
Total Revenue (TR) for owner at 12% TOT	\$81,030,000	\$81,030,000	\$81,030,000
TR + Tax Revenue at 12% TOT	\$90,753,600	\$90,753,600	\$90,753,600
Tax Rev at 12% TOT	\$9,723,600	\$9,723,600	\$9,723,600
ADR	\$200.00	\$200.00	\$200.00
Cost to Consumer at 16% Tax	\$232.00	\$232.00	\$232.00
% change in Cost to Consumer at 16% TOT	3.6%	3.6%	3.6%
% change in Rooms Sold at 16% TOT	-2.1%	-3.9%	-15.0%
Change in Rooms Sold at 16% TOT	-8,682	-15,917	-60,772
Total Revenue for Owner at 16% TOT	\$12,686,976	\$12,455,456	\$11,020,096
Total Tax Revenue at 16% TOT	\$79,293,600	\$77,846,600	\$68,875,600
Change in TR for Owner at 16% TOT	(\$1,736,400)	(\$3,183,400)	(\$12,154,400)
Additional Tax Revenue from TOT at 16%	\$2,963,376	\$2,731,856	\$1,296,496
Business Revenues Impact	(\$2,805,552)	(\$5,143,513)	(\$19,638,866)
Jobs Impact	-22.9	-42	-160.2
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Note: Numbers in parentheses represent negative numbers

Conclusions

By increasing the TOT rate in the defined area, policy makers are assuming demand is set to rise from 2019 levels. If demand is stable or contracts from 2019 levels as a baseline, the following effects are estimated to take place in the defined area and also spill over into Sonoma County overall:

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- One of three general scenarios are estimated to take place:
 - If the quantity demand rises beyond 2019 levels, all parties gain;
 - If the quantity demand falls less than 4.2% for each percentage increase in consumer cost of staying overnight, hoteliers lose, there are negative economic impacts, and there is a net gain in tax revenues;
 - If quantity demand falls more than 4.2% for each percentage increase in consumer cost, there is a net loss to government revenue, shifting tax gains to the new TOT rate from other tax revenues countywide.