San Diego Institute for Policy Research

San Diego
Economic Ledger

June 2007 Volume One Issue Three www.sandiegoinstitute.com

Chairman's Corner

Steven Francis, Founder & Chairman of the San Diego Institute for Policy Research

The San Diego economy historically was built on three key pillars - expenditures by the Department of Defense, high-value manufacturing, and the region's visitors industry. In modern times, high-technology and biotechnology development added a fourth pillar of economic capacity. This economic diversity has helped produce sustainable, stable growth, as well as remarkable prosperity that is envied by many other regions.

In this issue of the Economic Ledger, SDI examines the importance of the somewhat overlooked and taken for granted part of the modern regional economy - the visitors industry. We spotlight recent growth in room inventories and why continued investment in tourist promotion marketing will be critical if San Diego is to put "heads in beds" and realize the full potential of increased investment in lodging establishments.

We should not assume the visitors industry will continue to thrive without considerable marketing and promotion. The

(Continued on page 4)

Dashboard Observations

by Kelly Cunningham, Economist, Sr. Fellow

Although three indicators were up in the month of April 2007, all of San Diego's economic indicators continue to show lowering activity over the year.

The unemployment rate in San Diego continued to creep higher in April to 4.1 percent, still a relatively low rate suggesting "full employment." The rate is also up significantly since April 2006 when it was 3.7 percent.

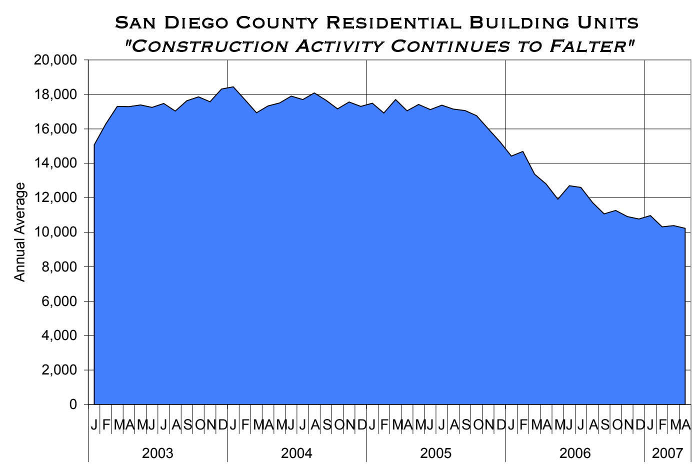
The number of unemployed San Diegans normally decreases between March and April. The increase of unemployed residents reported for April 2007 was the first increase of an April since 1995. The numbers are subject to revision, but clearly reveal a slowing trend in employment opportunities for San Diegans.

Residential construction also continues to show significant slowing over the past year. March 2007 reported a large number of 1,182 housing units approved for construction, due to a surge in multi-unit projects, but the number subsequently fell in April to only 555 units. Construction is also down 20.8 percent from April 2006 and for the past twelve months is off 20.1 percent over the previous year. The chart below shows the annual average continuing a two-year slump of residential construction in San Diego.

New business licenses issued by the City of San Diego reported a slight 0.3 percent seasonally adjusted increase from March to April, but was still 2.9 percent lower than the previous April number. For the past year, the number of licenses is down 4.0 percent from the previous year.

The San Diego stock index continues to reveal a somewhat normal roller coaster ride, rising and falling similar to national stock

(Continued on page 3)



Indicator	Apr 2007	Month Change	Annual Change
Unemployment Rate[1] San Diego County	4.1%	0.3% ▲	0.4% ▲
Residential Building[2] Units Authorized for Construction San Diego County	555	-44.8% ▼	-20.8% ▼
New Business Licenses[3] Issued by City of San Diego	1,263	0.3% ▲	-2.9% ▼
San Diego Stock Index[4] San Diego based public companies 2nd Thursday of month	140.0	6.3% ▲	-1.4% ▼
Economic Consumer Confidence Index[5]	114.8	1.4% ▲	

[1] California Employment Development Department.
[2] Construction Industry Research Board
[3] Business Tax Program, City of San Diego
[4] Second Thursday of month, Bloomberg News, San Diego Daily Transcript
[5] Survey by Competitive Edge Research and Communications, conducted the first week of May 2007.

For detail of data, see website: *www.sandiegoinstitute.com*

Inside this issue

San Diego Visitors Industry

- San Diego fully recovers from nation-wide slump in visitor travel following the dot.com meltdown and September 11, 2001 terrorist attacks.
- Record levels of visitor activity for almost all measurements of travel established in 2006.
- Despite considerable expansion of San Diego hotel numbers, occupancy rates and average room rates are at healthy levels.
- Marketing budget cutbacks put continued performance at risk.

(See Visitor Industry, page 2)

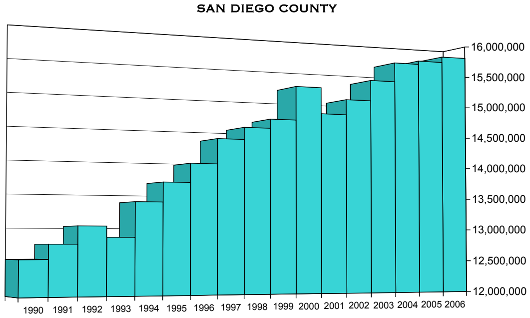
San Diego's Vital, Reliable, And Often Taken For Granted Visitor Industry

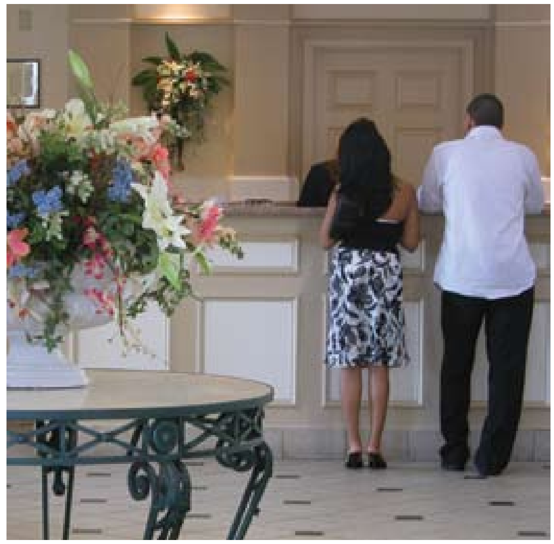
The visitor industry is often times overlooked or taken for granted as a viable engine of economic activity. Travel and tourism—encompassing transportation, accommodations, catering, recreation and services for travelers—is actually the world's largest industry and generator of jobs. According to the Travel Industry Association of America, the visitor industry is the nation's second largest services export industry, the nation's third largest retail sales industry, and one of America's largest employers. One out of every eight people in the U.S. civilian labor force is directly or indirectly employed in travel and tourism. In 2006, tourists spent nearly $2.0 billion every day in the U.S., translating to $82 million an hour or $1.4 million a minute.

The industry is vital to the economic stability, security and perception of the United States, contributing substantially to our cultural and social well-being. Currently, travel and tourism is one industry that America has a trade surplus as international tourists spent $7.2 billion more in the U.S. than citizens spent abroad last year. In total, international visitors spent $107.8 billion traveling in the U.S. in 2006, while U.S. resident travelers spent $100.6 billion traveling in foreign countries.

According to the most recent figures from the San Diego Convention and Visitors Bureau (ConVis), more than 32.2 million people visited San Diego County in 2006 and spent approximately $7.7 billion. This was an all-time record for the local industry, with a 6.8 percent increase over the $7.2 billion reported in 2005. The gain occurred despite record-high gasoline prices and soaring airfares.

Figure 1: Number of Overnight Visitors
San Diego County





Part of the explanation for San Diego's relative success may be that the region remains a popular drive-to market, as 68 percent of all overnight visitors use their own vehicle to travel to the region and, since 9/11, drive markets have performed relatively better than visitor markets drawing a larger percentage of visitors from air travel.

A nationwide slump in visitor travel followed the dot.com meltdown and September 11, 2001 terrorist attacks, pressuring local visitor businesses to regain former levels of visitor activity. Over the six years since that time, San Diego managed to not only recapture, but exceed almost all measures for visitor activity in the region, a tribute to local industry leader efforts. Branding strategies and focus on attracting specific target markets to San Diego were successfully implemented by ConVis, the San Diego Convention Center, and visitor industry businesses promoting San Diego as a brand niche for the travel market. This resulted in the region becoming a top visitor destination in the nation while many other visitor markets continued to flounder.

It should also be noted, that because of a lack of data in some segments of the visitor industry, the volume of visitors and resulting spending in the region has been previously underreported. The former estimates did not include an assessment for spending by Mexican day visitors coming to San Diego for tourism purposes (as opposed to work and other purposes), an allocated portion of airline tickets issued for travel to San Diego, and estimates for spending by meeting planners and exhibitors. The additional data led to an upward revision from $5.8 billion spending in 2005 to $7.2 billion.[1]

> "Absorbing fewer marketing dollars because of these government budget cutbacks, at the same time as competing markets step up their efforts, makes duplicating past performance much more difficult and improbable."

Some 164,000 San Diegans work in fields directly related to the visitor industry, including lodging, food service, attractions and transportation. Visitor based jobs account for 13 percent of all San Diego civilian payroll employment, or (mirroring national statistics) one in eight local jobs.

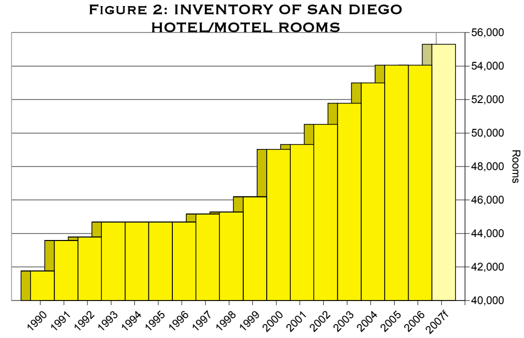
With the growth of technology-based industries in San Diego over the past two decades, communications, computer and software, biotechnology, and information technology industries altogether appear to have supplanted the visitor industry as San Diego's 3rd largest industry.

Increases in Inventory Not Depressing Rack Rates

During the 1990s, there was very little new hotel construction as a challenging national financial market and overhang of supply depressed investment activity. But between 1999 and 2006, the local hotel market has been robust with a net 8,764 rooms added. This represents a 19.4 percent increase of inventory. We could anticipate this to depress overall occupancy rates without a considerable corresponding increase in hotel visitors. Initially, this was the case. Occupancy rates dipped from an annual high of 73.8 percent in 2000 to 68.4 percent in 2002. Since that time, occupancy rates climbed back to 73.3 percent by 2006, a relatively healthy and profitable level for the local hotel market.

According to Smith Travel Research (STR), San Diego County's 73.3 percent occupancy rate in 2006 was the 4th highest among the top 25 metropolitan areas they

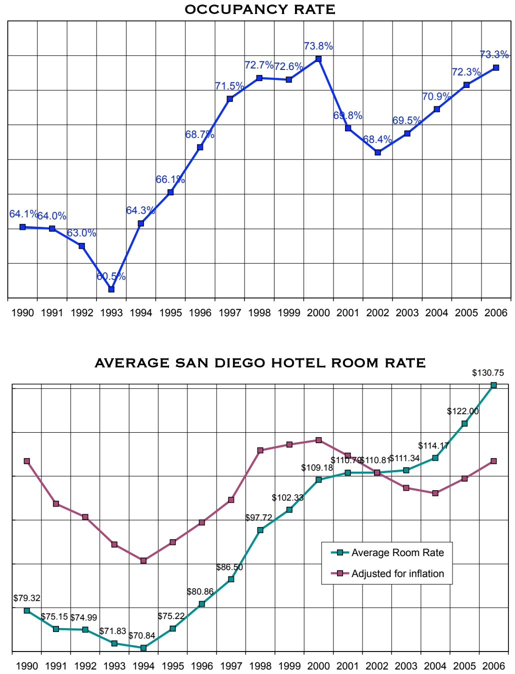
Figure 2: Inventory of San Diego Hotel/Motel Rooms



f: forecast. Source: San Diego Convention and Visitors Bureau tracked. Only Oahu, New York, and LA-Long Beach had higher rates. San Diego exceeded nearby competitor Anaheim, as well as San Francisco/San Mateo, Seattle, and Miami-Hialeah. Furthermore, San Diego and Los Angeles were the only areas among the top five to increase occupancy from the previous year, with San Diego's 1.5% gain much stronger than Los Angeles' 0.5%.

At the same time, the average room rate among area hotels jumped 20 percent from $109.18 in 2000 to $130.75 by 2006. Adjustment for inflation, however, shows a 4.0 percent decline in "real" rate. (See Figure 3.) Still, San Diego's hotel market performance during this troubled time has been stellar considering the growth of inventory and challenges absorbed by the travel market.

FIGURE 3: AVERAGE SAN DIEGO HOTEL-MOTEL OCCUPANCY RATE



Source: Smith Travel Research; San Diego Convention and Visitors Bureau.

Branding and continued promotion will play a critical role in ensuring that the rooms recently built are filled by travelers. ConVis' current branding campaign for San Diego sells the region as the ultimate setting for active relaxation, with an "unusually wide variety of activities for visitors of all ages and backgrounds." The campaign focuses on San Diego's core travel audiences: family travelers and affluent couples traveling without kids. In order to maximize advertising dollars, ConVis also partnered with the State of California and followed their national cable campaign to expand market reach. In addition, ConVis marketing programs also target a variety of niche travel markets (i.e., arts & culture, gay & lesbian, golfers, spa visitors, etc.), adding to the overall strength for the leisure travel market.

Visitor Marketing Budget Cutbacks

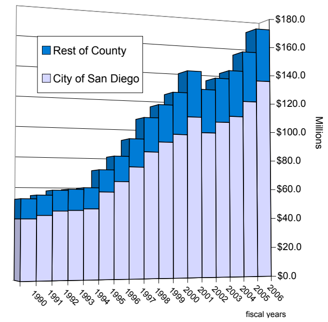
Despite the impressive performance of the visitor market, over the past three years, ConVis's budget has been cut by more than 37 percent, from $13.9 million in fiscal 2003 to $8.8 million in fiscal 2006. Under the current proposed city budget for 2007, ConVis's budget will remain at $8.8 million.

Absorbing fewer marketing dollars because of these government budget cutbacks, at the same time as competing markets step up their efforts, makes duplicating past performance much more difficult and improbable. An additional 2,300 hotel rooms are being built and to be added to San Diego's hotel inventory in 2007 alone, bringing total room numbers to 55,301. The need to fill these additional rooms and maintain profitable levels of occupancy will be a challenge for local hotels.

"Thanks to our region's excellent reputation as an outstanding visitor and meeting destination, we are optimistic that San Diego's visitor industry will see moderate growth in 2007," says David Peckinpaugh, ConVis president and CEO. "However, we cannot lose track of the fact that many other destinations are competing for our business and stepping up their efforts. Major cutbacks in marketing funds at the local level continue to impact our ability to competitively market San Diego."[2]

In total, San Diego cities collected $172.6 million of transient occupancy taxes (TOT). During fiscal year 2006, nearly 4 out of the 5 dollars collected were by the City of San Diego. The City's TOT revenues have nearly tripled since 1994.

FIGURE 4: TRANSIENT OCCUPANCY TAXES COLLECTED IN SAN DIEGO



A comparison of sales and room city taxes on hotel rooms among 27 major competing visitor markets reveals San Diego having the lowest net hotel tax rate at 10.5 percent. The list is led by St. Louis, MO-IL at 22.2 percent, followed by Boston, MA at 17.5 percent, and Houston, TX at 17.0 percent. ■

1 ConVis indicates revised figures will be calculated for the years back to 2000, but are not available at this time.

2 Joanne DiBona, "2007 Visitor Industry Forcast," San Diego Convention & Visitors website - www.sandiego.org/article/media/700.

DASHBOARD OBSERVATIONS

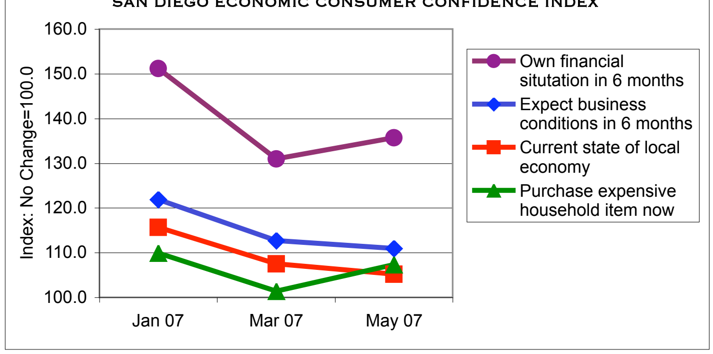
continued from page 1

indexes. The index for locally headquartered companies was up 6.3 percent in April 2007, but 1.4 percent lower than it stood a year ago.

The San Diego Economic Consumer Confidence index (below) shows slight improvement in May 2007 over the index in March. The overall index increased from 113.2 in March 2007 to 114.8 in May, a 1.4 percent rise of overall confidence.

Local consumer's outlook for their own personal situation improved despite increasing doubts about the overall economy. 5.9 percent more respondents believed that it was a good time to purchase an expensive household item and 3.6 percent had a more positive outlook on their future financial prospects. On the other hand, attitudes toward the overall economy continued to slide, although not quite as much as the previous bi-monthly slip. Views on the current state of the local economy slipped another 2.2 percent, after falling 7.0 percent the previous two months. Expectations for future business conditions to improve also faltered 1.6 percent, following the former 7.6 percent decline. Possible sources of anxiety could be record-high gas prices and continued sluggishness in the housing market. ■

SAN DIEGO ECONOMIC CONSUMER CONFIDENCE INDEX



SAN DIEGO ECONOMIC CONSUMER CONFIDENCE INDEX

Index*	Jan 07	Mar 07	May 07	Jan-Mar	Mar-May
Overall	124.7	113.2	114.8	-9.2%	1.4%
Current:					
State of local economy	115.6	107.6	105.2	-7.0%	-2.2%
Purchase expensive household item	109.9	101.4	107.3	-7.7%	5.9%
Six Months in Future:					
Expect business conditions	121.9	112.7	110.9	-7.6%	-1.6%
Own financial situation	151.2	131.0	135.7	-13.3%	3.6%

*Index: 100.0=no change.

Source: Competitive Edge Research & Communication, Inc.; San Diego Institute for Policy Research

continued from page 1

Transient Occupancy Tax (TOT) charged to hotel guests was specifically designed for the express purpose of the "promotion of tax-generating travel, tourism and convention activities." It should be spent as an investment, the marketing yielding even more revenue. Properly used to promote San Diego as a destination, it is a good example of market driven, supply side economics.

What happens to the tax dollars, paid by tourists and convention delegates, and not by local San Diego taxpayers? A significant portion of the TOT supplements the City's General Fund and underwrites basic municipal services, such as road repair and park maintenance. The revenues have also been used to fund cultural events, arts organizations and community-based programs throughout the city. In addition, the TOT provides funding to hire police officers for local neighborhoods, train firefighters and promote economic development.

And it does not stop there. The TOT helps maintain many of the amenities enjoyed not only by tourists, but by San Diego area residents as well, such as Balboa Park, Mission Bay Park, and the Trolley. The TOT is also the source of funding for the expansion of San Diego's enormously successful Convention Center and PETCO Park.

It is easy to see how visitors to San Diego benefit our local economy tremendously. In sum, tourism's significant contributions to our local economy are quite clear. Not only does the industry create thousands of jobs in the region, it also helps provide a critical source of tax dollars to underwrite programs and projects of primary benefit to all San Diegans.

As always, we welcome your feedback and input. ■

– Steven Francis,
Founder & Chairman

THE SAN DIEGO INSTITUTE FOR POLICY RESEARCH

The San Diego Institute for Policy Research, LLC ("SDI") is established as a non-partisan organization whose goal is to improve the efficiency and effectiveness of the public sector throughout San Diego County. We believe that there are powerful insights that can be gained by examining how the private sector uses various tools and management techniques to succeed. We believe, as general principals, in limited government, individual freedom and responsibility. We also believe that local government governs best when it focuses on core competencies and services.

SAN DIEGO INSTITUTE FOR POLICY RESEARCH

Phone: 858-320-7509
Fax: 858-453-0607
E-mail: kcunningham@sandiegoinstitute.com

SAN DIEGO INSTITUTE FOR POLICY RESEARCH

8910 University Center Lane
Suite #220
San Diego, CA 92122