



# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Jim Shannon  
Nanci Klein

**SUBJECT:** ARTS, CULTURE AND  
HOSPITALITY FUNDING

**DATE:** June 4, 2023

Approved

Date: 6/5/2023

## BACKGROUND

This Manager's Budget Addendum responds to direction in the Mayor's June Budget Message for Fiscal Year 2022-2023, as approved by the City Council, which included the following direction from a memorandum authored by Councilmembers Peralez, Carrasco, Davis, and Arenas: *"Direct the City Manager to invest in re-vitalizing our arts, hospitality, and visitor sectors to spur business recovery, job growth and economic fiscal health by identifying long-term budget policy strategies that can guide to the continued long-term investment of our Transient Occupancy Tax (TOT) program that serves the art, culture, and hospitality industries and return back the next fiscal year to Council with these strategies."* This Manager's Budget Addendum discusses the sources of City funding that support the arts, cultural, tourism, and hospitality sectors, current fiscal outlook, funding strategies and recommendations for continued investment in these areas.

## ANALYSIS

The creative and tourism industries have long been valued contributors to San José's cultural, economic, and community prosperity. The City of San José was a municipal innovator when it integrated its local arts agency, the Office of Cultural Affairs, with its Office of Economic Development emphasizing the strategic and symbiotic relationship of these critical municipal services. The City partners with Americans for the Arts and SVCCreates in the Arts and Economic Prosperity studies, with the newest research to be released in October 2023. The most recent economic impact data from 2015 revealed that the San José nonprofit art sector along contributes over \$191 million to the local economy through direct and indirect spending. The sector employs 4,255 jobs. The nonprofit art sector also contributes fiscal impacts to local and state government, estimated at approximately \$13.5 million. These are conservative estimates that do not represent the economic impacts of local multidisciplinary artists or commercial creative industries, such as those that present the performing arts. The tourism and hospitality sectors also greatly contribute to economic and fiscal prosperity through direct and indirect expenditures.

### ***Funding Sources and Uses***

Ongoing support for the arts, cultural, tourism, and hospitality sectors is largely provided by the Transient Occupancy Tax (TOT), the Public Art allocation through the City’s Capital Improvement Program, grants secured by the Office of Economic Development and Cultural Affairs (OEDCA), service agreements with other agencies, and the General Fund. Each of these sources is briefly discussed below.

#### ***Transient Occupancy Tax***

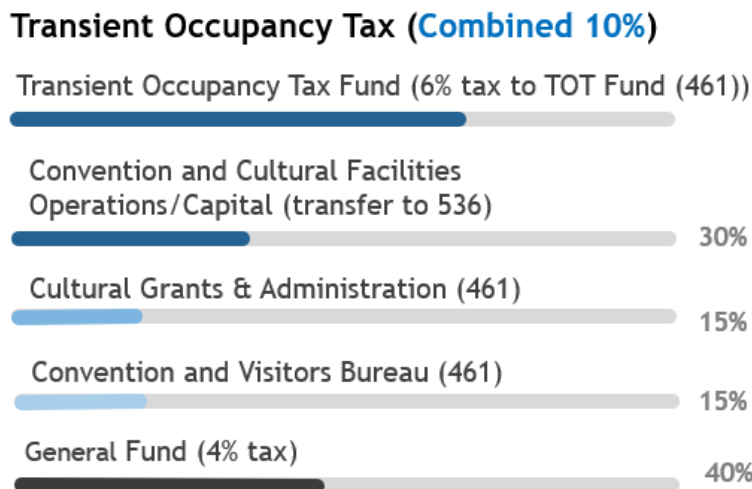
The City’s TOT, often referred to as hotel tax in some jurisdictions, imposes a combined tax of 10% on the rent charged for lodging to a transient for occupancy. A “transient” is defined as any person who exercises occupancy or is entitled to occupancy for a period of 30 consecutive calendar days or less. The TOT consists of separate assessments directed to a special fund (6%) and to the General Fund (4%).

The level of TOT collections is directly related to the status of the economy. When the economy is growing, conventions, business travel and tourism activity increase, which leads to higher occupancy rates in hotels. With increased occupancy, the hotels are able to raise room rates, which positively impacts TOT collections. Conversely, when the economy is declining, TOT revenues tend to decrease and can do so quite rapidly.

Chapter 4.72 of the San José Municipal Code, passed in 1982, authorizes the collection of a 6% tax deposited into the TOT Fund, with 50% of the revenue designated for subsidizing the operation of City-owned convention and cultural facilities (Figure 1). This portion is received in the TOT Fund and transferred to the Convention and Cultural Affairs Fund (also referred to as Fund 536) to support facility operations by a non-profit partner, Team San Jose. Team San Jose assumed responsibility for operation of the Convention and Visitor’s Bureau, San Jose McEnergy

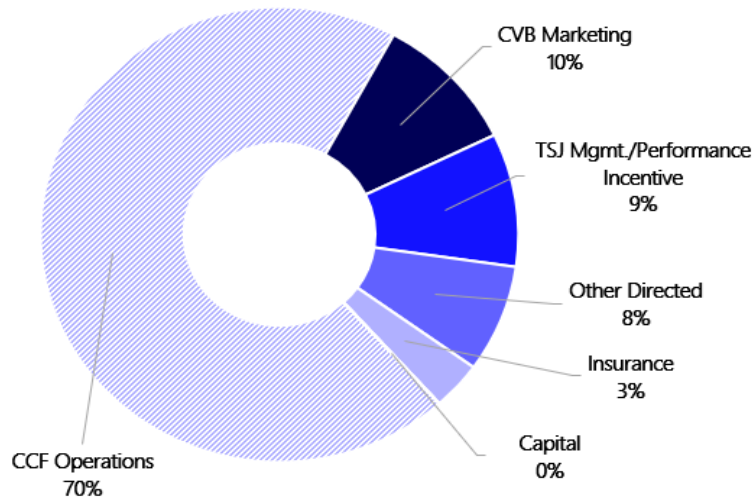
Convention Center, South Hall, California Theatre, Parkside Hall, Montgomery Theater, Center for the Performing Arts, and related facilities and grounds in 2004-2005, following a transition from the City’s Convention, Arts & Entertainment Department. Excess revenue in the Convention and Cultural Affairs Fund also supports reserves for future operating needs, as well as the maintenance and capital rehabilitation improvement of the above facilities via transfer to the Convention and Cultural Affairs Capital Fund (Figure 2).

#### **Figure 1. Transient Occupancy Tax Distributions**



**Figure 2. Convention and Cultural Affairs Fund Distributions**

Support for Convention and Cultural Facilities Operations/Capital (536)  
(\$9.1M transferred from TOT Fund for 2022-2023, plus \$2.5M from American Rescue Plan Fund)



The remaining 50% stays in the TOT Fund and may support: a) arts programs, grants, and services, related OEDCA operating costs (staff, administration, and public art maintenance); and b) Convention and Visitors Bureau (CVB) operations. While allocations are subject to the discretion of the City Council, in practice, they have historically been equally split; the portion allocated for cultural arts includes funding of cultural arts grants and the Office of Cultural Affairs (OCA) division of OEDCA. Per the municipal code, allowable uses are OCA operating costs (staff and administration), arts programs and arts grants. Each year, the OCA budget and programs including grant awards are recommended based on projected TOT<sup>1</sup>.

Chapter 4.74, passed in 1985, authorizes the collection of a 4% tax deposited into the General Fund as a one of many revenue sources used to fund City services (Figure 1). While there are no mandated percentages for how the 4% General Fund allocation should be spent, each year the City's budget includes substantial General Fund spending to arts and cultural events. As shown in Figure 3, an ongoing General Fund allocation of \$4.5 million is included in the 2023-2024 Proposed Operating Budget to support the operation and maintenance, repair, and improvement of City-owned facilities managed by non-profit partners. Further, any substantial capital improvement to these facilities is the responsibility of the City. As listed in Figure 4, a total of \$12.1 million is budgeted in the General Fund in the 2023-2024 Proposed Operating Budget for critical capital rehabilitation projects.<sup>2</sup> For reference, this total General Fund contribution toward arts operators and facilities in 2023-2024 of \$16.6 million exceeds the 2023-2024 revenue estimate from the 4% TOT of \$16.0 million estimated to be received in the General Fund.

<sup>1</sup> Please see MBA #37, Proposed 2023-2024 Arts and Cultural Development Grants:  
<https://www.sanjoseca.gov/home/showpublisheddocument/98834/638211478058370000>

<sup>2</sup> The 2022-2023 Adopted Capital Budget also included \$7.5 million for one-time capital improvements at cultural facilities projects.

**Figure 3. Cultural Facility Operations and Maintenance (General Fund)**

<b>Cultural Facility Operator</b>	<b>2023-2024 (\$)</b>
Children’s Discovery Museum	\$357,789
History San Jose	\$928,818
San Jose Museum of Art	\$591,133
SJSU / Hammer Theatre Center	\$337,684
School of Arts & Culture at Mexican Heritage Plaza	\$493,319
The Tech Interactive	\$1,473,855
<b>Total Operating Contribution</b>	<b>\$4,182,598</b>
<b>Cultural Facility Capital Maintenance</b>	<b>\$319,981</b>
<b>TOTAL</b>	<b>\$4,502,579</b>

**Figure 4. Cultural Facility Capital Project Funding (General Fund)**

<b>Cultural Facilities Capital Rehabilitation Projects</b>	<b>2023-2024 (\$)</b>
Center for the Performing Arts – Chiller, Cooling Tower, and Boiler Replacement	\$7.6 million
San José Museum of Art – Cooling Tower Replacement	\$2.9 million
The Tech Interactive – Chiller and Cooling Tower Replacement	\$1.2 million
Children’s Discovery Museum – Curb and Walkway Rehabilitation	\$0.4 million
<b>TOTAL</b>	<b>\$12.1 million</b>

*Public Art*

In accordance with the Public Art Master Plan approved by the City Council on March 13, 2007 and Chapter 22.08 (Art in Public Places) of the San José Municipal Code, one percent of all construction project funding included in the Capital Improvement Program is generally required to be allocated toward public art projects managed by OEDCA. Exclusions to this one percent public art contribution requirement include certain types of projects such as those for seismic and Americans with Disabilities Act retrofit, rehabilitation, maintenance and operations, non-construction projects (such as studies), affordable housing, and the Water Pollution Control Plant. Due to outreach and development processes, the timing and completion of funded projects varies from the date of initial funding. Programmed funding in the 2023-2027 Adopted Capital Improvement Program totaled \$7.6 million over a five-year period. The \$1.9 million currently included in the 2024-2028 Proposed Capital Improvement Program will increase as part of the Adopted Budget Process, as a significant portion of \$7.3 million budgeted in 2022-2023 is anticipated to be rebudgeted into 2023-2024 to continue projects already in process.

### *Other Sources*

Intermittent grants and service agreements secured by OEDCA also support special initiatives and projects, as well as staffing and administration. Subject to City Council approval scheduled for its June 20, 2023 meeting, OEDCA is anticipated to provide professional services to the County of Santa Clara for the development and implementation of its recently approved ‘One Percent for Art Projects’ which similarly commits one percent of the budget for a designated Capital Improvement Project for public art. As funding for the City’s public art projects fluctuate with the Capital Improvement Program, inter-agency agreements are viewed as a means of retaining a talented Public Art Program staff, whose hours are primarily charged to capital projects.

Allocations from the General Fund and other funds, such as the American Rescue Plan (ARP) Fund and Coronavirus Relief Funds and public/philanthropic agency grants, have provided additional support for arts and cultural programs and facilities. Transfers from the ARP Fund to the Convention and Cultural Affairs Fund, totaling \$5.0 million over 2021-2022 and 2022-2023, partially buoyed recovering TOT revenues for convention and cultural facilities operations in the wake of the significant declines due to the COVID-19 pandemic and associated public health measures. Similarly, the ARP Fund, via the revenue loss reimbursement provision, contributed a total of \$4.0 million to the General Fund as supplemental funding for Cultural Arts grants in 2021-2022 and 2022-2023. As all of the ARP funding has been allocated, the 2023-2024 Proposed Operating Budget recommends one-time allocation from the General Fund of the \$1.0 million, as directed by the City Council’s approval of the Mayor’s March Budget Message for 2023-2024, for continued bridge funding for Cultural Arts grants as TOT revenues continue their slow rebound. In addition, the General Fund also supports one-time allocations for specific cultural events, projects, and recipients, often via City Council budget documents and Mayor’s Budget Messages, supported by the Essential Services Reserve.

### *Historical Revenues and Spending*

Figure 5 below shows a ten-year perspective annual TOT revenues. Of course, looking back over ten-years omits much of the City’s budgetary challenges beginning in the early 2000s when the “Dot Com Bust” and “Great Recession” significantly impacted City revenues – including State takeaways – while the City’s costs related to retirement contributions rapidly escalated. The result was the “Decade of Deficits” in the General Fund that required the reduction of a wide array of services, wage reductions, and layoffs. Even the 7,033 budgeted full-time equivalent positions recommended in the 2023-2024 Proposed Operating Budget falls short of the peak position count of 7,481 in 2001-2002. These actions also included a reduction of General Fund support for arts, culture, and hospitality funding.

As shown by the data below, TOT revenues exhibit considerable volatility in response to prevailing economic conditions, often increasing or decreasing by more than 10% annually. This variability reinforces the need for a reserve strategy to mitigate the infrequent, yet significant shocks that coincide with recessionary periods. The COVID-19 pandemic caused historic, precipitous revenue declines of 74% (\$37.9 million) from the pre-pandemic high of \$51.4 million in 2018-2019, exceeding the declines experienced in the preceding “Great Recession” (28%) and even the “Dot Com Bust” (48%). The unforeseen duration and severity of the pandemic’s impacts, particularly on the hospitality industry, required the liquidation of all prior reserves and reallocation of unspent

capital funding, once viewed as robust relative to prior recessionary impacts, that exceeded \$15 million. While TOT revenue has since continued to improve into 2022-2023, estimated to reach \$40 million in 2022-2023, it remains well below pre-pandemic levels.

**Figure 5. Historical TOT Revenue (10-Yr.)**

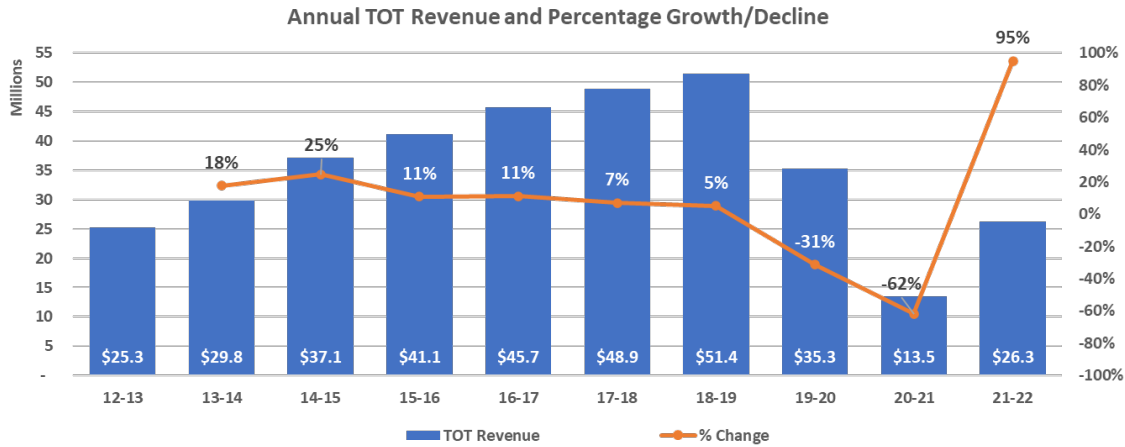


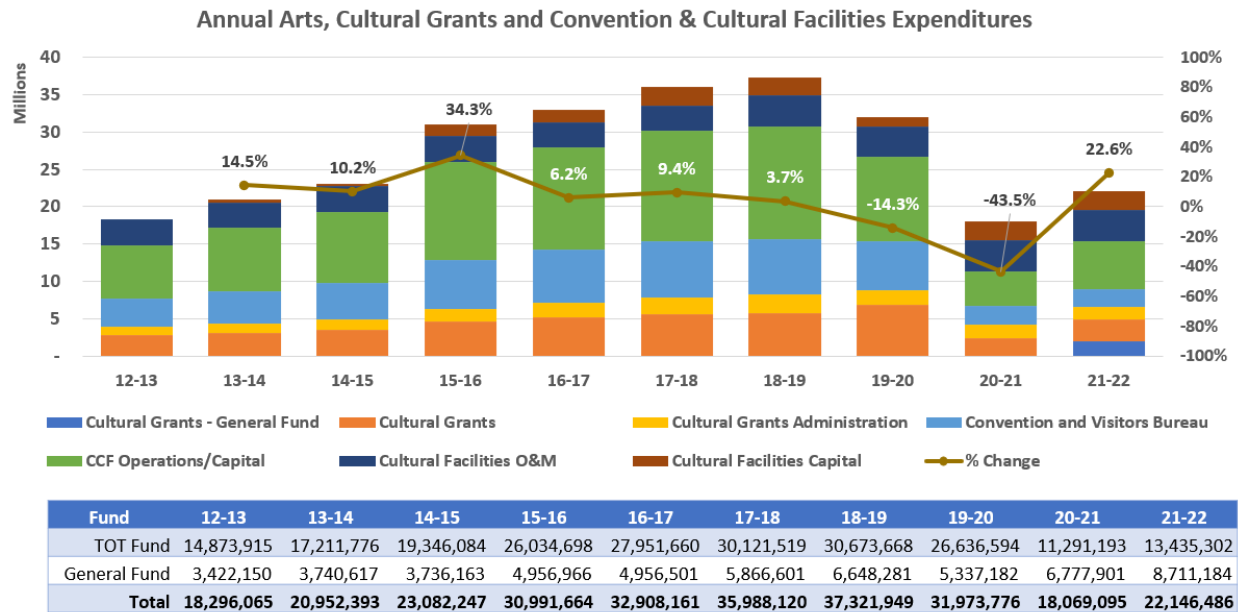
Figure 6 below shows a ten-year history of expenditures in the TOT Fund and General Fund related to the arts, convention, and hospitality sectors. As shown, outlays steadily increased through 2018-2019, enabling funding to be set aside in reserves, as well as capital improvements to convention and cultural facilities. However, the abrupt revenue decline starting in 2019-2020 immediately exhausted these reserves and required previously committed funds for capital projects to be reallocated to mitigate the pandemic’s severe impact on available funding, including preserving the core operations of the CVB, and the convention and cultural facilities managed by Team San Jose.

Funding levels for activities largely supported by the TOT Fund – cultural grants, CVB operations, and convention and cultural affairs operations and maintenance – were the most susceptible to, and constrained by, the pandemic’s impacts, requiring supplementation from the ARP Fund and General Fund, as noted above, to mitigate significant year-over-year declines. Expenditures for arts programs, grants, and services, and other related OEDCA activities totaled \$6.9 million in 2019-2020, decreasing to \$2.4 million in 2020-2021 (76% decline).<sup>3</sup> An infusion of \$2.0 million into the General Fund from the ARP Fund increased 2021-2022 outlays to \$4.8 million. Another infusion of \$2.0 million was continued in 2022-2023.

<sup>3</sup> Expenditures include funds rebudgeted from prior years and encumbrances, increasing the 2019-2020 basis above base allocations. Totals exclude OEDCA administration costs supported by the TOT Fund, as well as funding allocated for Public Art through the City’s Capital Improvement Program.



**Figure 6. Historical Expenditures by Category**



**2022-2023 Outlook & 2023-2024 Proposed Operating Budget**

While TOT revenue has not returned to pre-pandemic levels, it is significantly exceeding the initial budget estimates for 2022-2023, providing an opportunity to replenish reserves to cushion against future economic uncertainty and stabilize annual funding levels for arts programs, grants, and services.<sup>4</sup> Revenues through April 2023 were 63.0% above prior year collection levels, backed by positive hotel performance indicators that have exhibited a relatively stable growth pattern. Accordingly, the 2023-2024 Proposed Operating Budget for the TOT Fund reflects the first year of a multi-year plan, consistent with the current 2024-2028 Five Year Forecast and Revenue Projections, to set aside excess revenue in a Cultural Grants Reserve – estimated at \$2.5 million in 2023-2024 – that may be drawn upon to provide funding stability.

In accordance with the City Council-approved Mayor’s March Budget Message for Fiscal Year 2023-2024, the 2023-2024 Proposed Operating Budget continues a \$1.0 million one-time investment from the General Fund to supplement arts and cultural grant funding. Combined with the projected \$5.4 million in funding from the TOT Fund, this allocation brings overall funding for arts and cultural grants, programs, and services to \$6.4 million in 2023-2024. This projected funding for 2023-2024, excluding reserves, is still slightly below recent 2019-2020 expenditures (\$6.9 million) but exceeds 2018-2019 expenditure levels (\$5.8 million).<sup>5</sup> These variances are partly attributable to the programmatic reserves that were previously included within the Cultural Grants appropriation, which proved vital to mitigate the pandemic’s impacts. In contrast, the

<sup>4</sup> Refer to [Manager’s Budget Addendum 37, Proposed 2023-2024 Arts and Cultural Development Grants](#), which recommends total grant allocations of \$4.1 million for 2023-2024, a 9% increase over the \$3.8 million awarded in 2022-2023. Grants are one of the allowable uses of TOT funds, which also include OEDCA-managed programs and services, as well as OCA operating costs (including staff, administration, and public art maintenance).

<sup>5</sup> Funding levels reflect base allocations consistent with projected 2023-2024 TOT revenue, not inclusive of 2022-2023 savings anticipated to be rebudgeted as part of the 2022-2023 Annual Report, or the final reconciliation of revenue received in 2022-2023.

recommended reserve strategy sets aside similar funding levels (15% target) in a designated, more transparent reserve that will be actively managed through budget development and modification cycles.

### ***Long-Term Funding Considerations***

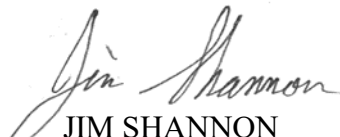
The City values the art and tourism sectors, which drive positive cultural, economic, and community impacts and benefits. The Administration has sought to stabilize funding for the arts and tourism through a variety of funding sources since the Great Recession and subsequently since the COVID-19 pandemic and recovery. Unfortunately, the ability to make additional investments, even in these important areas, is extremely limited. The Administration seeks to continue to work with our community partners to advance efficacy and support the highest and most potential of the sectors and foster collaboration.

Advocates for arts and hospitality interests have recently requested that the City Council dedicate the General Fund portion of the tax (4% TOT) to fund arts and hospitality related programs and initiatives in addition to the cultural facilities operating and capital support already provided. While this additional funding could certainly be put to good use, particularly given the unprecedented impacts of the COVID-19 pandemic and extended recovery period, it would come at the expense of other critical City services.

As noted in the 2024 – 2028 Five-Year Forecast and Revenue Projections, the 4% TOT is an ongoing revenue source anticipated to contribute \$16 - \$21 million annually to the General Fund. If the \$16 million from the 4% TOT were to be transferred to the TOT Fund on an ongoing basis in 2023-2024, it would have the effect of reducing the incremental surplus from \$35.3 million to \$19.3 million.

The Administration recommends maintaining the current funding framework, with the acknowledgement that future budget cycles will continue to evaluate the need to supplement arts, culture, and hospitality funding until TOT revenues fully recover. To pursue strategies to increase funding for arts, culture and hospitality, the City Council can direct the Administration to:

- Continue to aggressively pursue external grant funding;
- Pursue a percent for art allocation from private development, also a request from arts and hospitality advocates, which was among the City Council's top policy interests pre-pandemic; and
- Investigate the feasibility of other funding mechanisms, including a potential ballot measure, that could be leveraged for arts, culture, and hospitality funding.

  
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