Potential Impacts of Proposed Increase to the Transient Occupancy Tax (TOT) in Carmel-by-the-Sea

Executive Summary

The proposed increase of Carmel-by-the-Sea's Transient Occupancy Tax (TOT) presents material fiscal and economic risks that warrant further analysis before advancing to the ballot. While the City's need for increased revenue is understood, the current City Staff Report does not sufficiently evaluate demand response, competitive positioning, secondary tax impacts, negative impacts on hoteliers and merchants, or long-term structural consequences to the hospitality sector—one of the City's largest General Fund contributors.

Key findings:

- The proposal assumes revenue gains without accounting for reduced demand, occupancy shifts, or length-of-stay impacts.

- A 2% TOT increase, for the purposes of example, would absorb more than half of all projected future hotel revenue growth, leaving hotels with real growth below inflation.

- Historical experience shows that sustained tax pressure without reinvestment capacity leads to deterioration of lodging quality and long-term revenue erosion.

- Carmel-by-the-Sea would lose a key competitive advantage relative to nearby destinations with equal or lower TOT rates, and will likely lose overnight visitors to neighboring cities, who will then become Carmel day-trippers.

- Reduced overnight visitation risks offsetting TOT gains with losses in sales tax and business vitality.

Recommendation: City Council should delay any ballot action until a comprehensive economic analysis and stakeholder engagement process is completed, ensuring informed, risk-aware decision-making.

Further Detail: Analytical Gaps and Policy Risks

1. Overnight Lodging Demand Response Must Be Considered

The staff report assumes a TOT increase will generate additional revenue without evaluating how higher effective room prices may impact demand. There is no analysis of price elasticity, occupancy shifts, length of stay, or substitution to nearby destinations. Established hospitality economics research demonstrates that even modest price increases can reduce demand, particularly in luxury and destination markets such as Carmel-by-the-Sea.

Policy Risk: Reduced demand would erode projected TOT gains and negatively impact broader local economic activity.

2. Comparison to Competitive Jurisdictions

The staff report compares Carmel's base TOT rate but does not evaluate total effective lodging costs. Carmel's higher average daily rates magnify the impact of any tax increase.

The City of Carmel already collects substantially more per hotel room night sold than any of the other local jurisdictions, with the exception of unincorporated Monterey County which benefits from very high room rates in Pebble Beach and luxury Big Sur and Carmel Valley properties. Significantly, the two jurisdictions (Monterey County and Carmel-by-the-Sea) that have the lowest tax rates produce the most per room **(See Exhibit A).**

The staff report does call out Half Moon Bay as an example of a comparable destination which is now at a 15% TOT rate. Using that example and digging deeper: In FY 2022 Half Moon Bay increased TOT from 12% to 14%, then in 2023 it increased to 15%. That destination then experienced a reduction in Occupancy which contributed to a dramatic 32%(!!) loss of TOT, which had been budgeted at $9 million **(See Exhibit B).**

Policy Risk: Raising the TOT rate risks undermining Carmel's proven per-room revenue productivity by eliminating a competitive pricing advantage that has historically generated higher returns per room night than higher-tax jurisdictions.

3. Proven Success of Reinvestment-Driven Growth (HID)

Since the creation of the Carmel Hospitality Improvement District (HID) in 2013, hotels have self-assessed an additional 2% to fund marketing. This approach has driven organic revenue growth at approximately 125% of Consumer Price Index (CPI), generating significant incremental TOT revenue for the City without raising tax rates. **(See Exhibit C)**

Growth rate of TOT revenue for the City has outpaced both Property Tax and Sales Tax revenues. Even without a rate increase, **TOT is organically outpacing every other revenue source**, driven by reinvestment, renovations, and strong market rates. Raising the TOT rate risks disrupting the one category that is already delivering consistent, growing returns.

Policy Insight: Reinvestment-driven growth has proven more effective than tax increases in strengthening City revenues.

4. Revenue Projections Must Account for Regional Supply Changes

The projected incremental revenues assume stable occupancy and unchanged room inventory. This approach does not account for the imminent addition of approximately 1,000 new hotel rooms within the broader Monterey Peninsula region, which will increase competition for visitors and place downward pressure on occupancy and rates.

As regional supply expands, Carmel-by-the-Sea's hotels will face heightened competition from nearby jurisdictions offering lower effective lodging costs. If Carmel were to forgo its current lower tax rate advantage, demand is likely to shift toward these alternatives, resulting in reduced overnight visitation within the City.

A decline in overnight stays would have secondary impacts beyond lodging revenue, including an increase in day-trip visitation from surrounding areas. This dynamic would reduce overnight-generated tax revenues while increasing traffic, parking demand, and infrastructure wear within the Village.

Policy Risk: Increased regional competition combined with higher effective lodging costs will reduce overnight visitation, weaken net fiscal returns, and shift visitation patterns toward higher-impact, lower-yield day trips.

5. Projected Net Revenue Loss to Hotels and Merchants

Raising the TOT rate, using a 2% increase as an example, is projected to result in approximately $2 million in annual hotel revenue losses and an estimated $1.5 million decline in merchant spending due to price elasticity. **(See Exhibit D).**

Visit California forecasts statewide visitor spending growth of only 2.4%–2.6% annually—slower than recent years (https://industry.visitcalifornia.com/research/reports/travel-forecast). Under these conditions, a 2% TOT increase would capture approximately 53%–57% of all future hotel revenue growth for the City, leaving hotels with real growth of just 1.5%–1.8%, well below CPI.

In addition, overnight visitors account for a disproportionate share of local sales tax generation, as documented by standard tourism-economic methodologies (e.g., Dean Runyan Associates). Any reduction in room nights risks offsetting TOT gains with losses in sales tax and business activity.

Policy Risk: Suppressed reinvestment capacity, reduced economic vitality, and potential net-negative impact on total City revenues.

6. Long-Term Structural Impacts

With long-run CPI averaging approximately 3.9%, a TOT increase constrains real revenue growth while operating costs continue to rise. This creates structural margin pressure rather than a one-time adjustment. Historical experience (1975–1990s) demonstrates that cumulative tax pressure contributed to deterioration of lodging quality, prompting City intervention in 2006.

Policy Risk: Declining lodging quality and long-term erosion of the visitor experience.

7. Stakeholder Outreach

Lodging-related revenues account for more than 25% of the City's General Fund. Hospitality industry stakeholders should be formally engaged prior to analysis. A more thorough and inclusive consultation would materially improve revenue projections and reduce fiscal risk.

Policy Risk: Reduced analytical reliability and increased stakeholder and voter uncertainty.

Exhibit A

2025 TOT Production by Jurisdiction

City	Rooms	Occ%	ADR	RevPAR	TOT Rate	TOT	TOT/Rm	Source
Monterey County (unincorporated)	1,815	71.1%	$ 394	$ 279.83	10.5%	$ 19,459,678	$ 10,724	A
City of Carmel-by-the-Sea	**970**	**69.2%**	**$ 381**	**$263.58**	**10.0%**	**$ 9,527,386**	**$ 9,822**	**D**
City of Monterey	4,729	71.1%	$ 235	$ 167.14	12.0%	$ 34,620,131	$ 7,321	A
City of Pacific Grove	951	n/a	n/a	$ 164.62	12.0%	$ 6,857,000	$ 7,210	B
City of Marina	980	69.1%	$ 188	$ 129.64	14.0%	$ 6,492,037	$ 6,625	A
City of Seaside	665	n/a	n/a	$ 140.76	12.0%	$ 4,100,000	$ 6,165	C

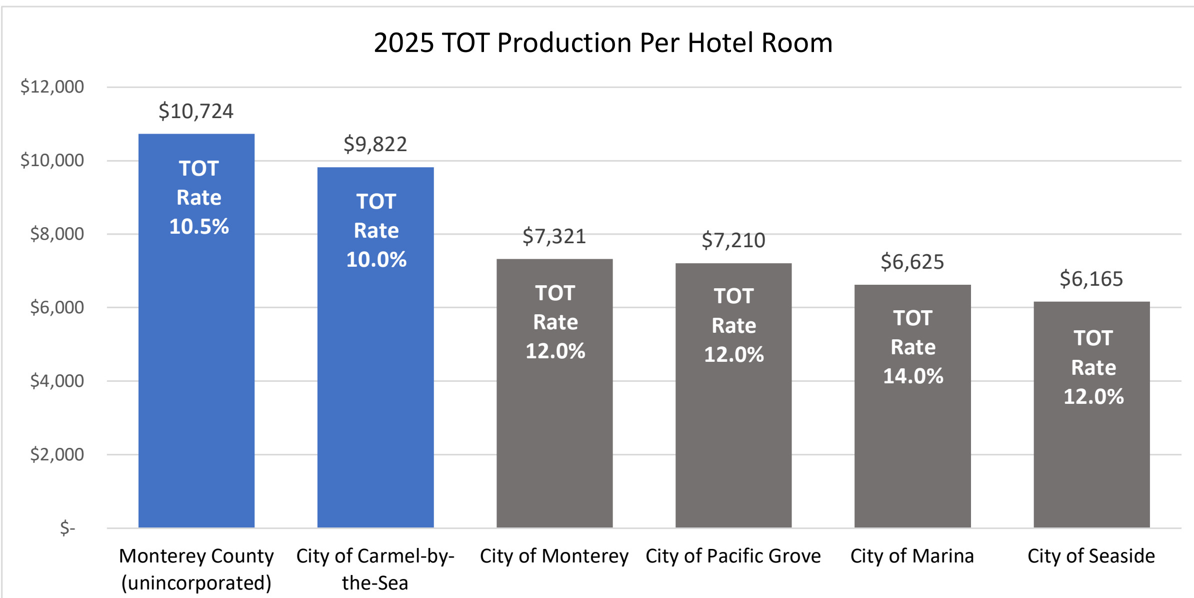
Source:

A See Monterey/STR

B City of Pacific Grove FY 2025-26 Budget, exlcuding Kimpton Hotel

C City of Seaside FY 2025-26 Budget

D City of Carmel TOT Reporting, 12 months ending October 2025



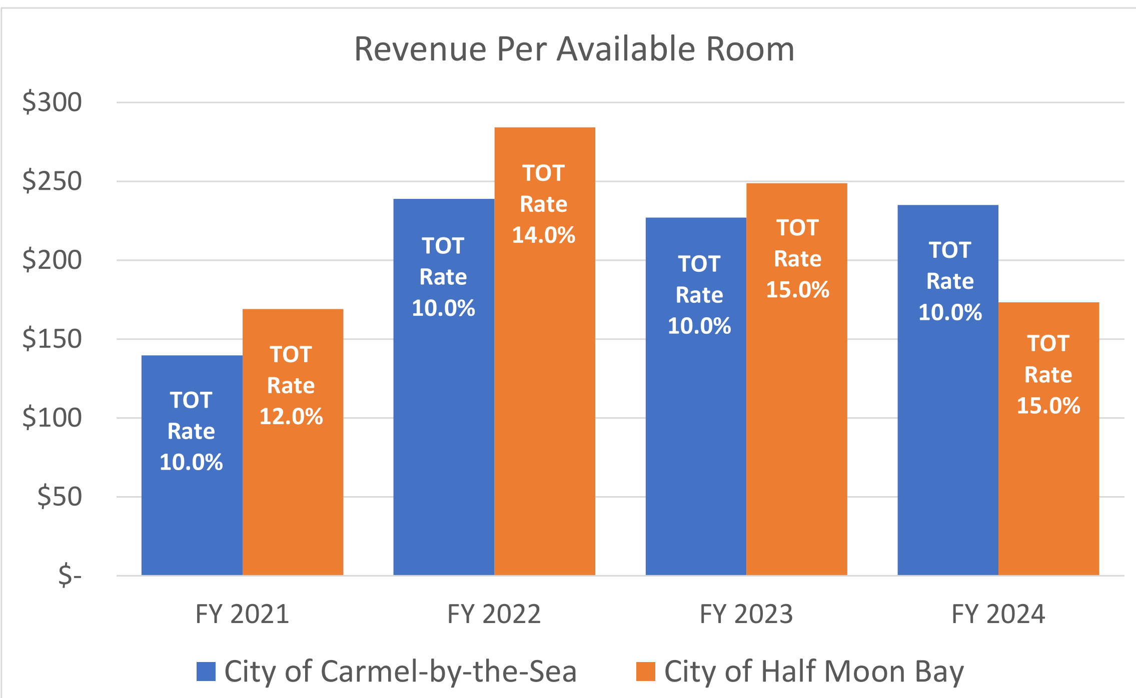
This analysis highlights a clear and consistent relationship between pricing power, RevPAR, and Transient Occupancy Tax production per room, rather than between higher tax rates and stronger fiscal outcomes. Jurisdictions with the lowest TOT rates and highest RevPAR, notably Carmel-by-the-Sea (10.0%) and unincorporated Monterey County (10.5%), generate the highest TOT per room, at $9,822 and $10,724 respectively. These outcomes are driven by materially higher ADRs and RevPAR, which more than offset their lower tax rates. Carmel serves as the baseline comparator, with several neighboring cities producing 34% to 59% less TOT per room despite higher nominal tax rates.

Conversely, cities that have adopted higher TOT rates (12% to 14%) but operate in lower-ADR, lower-RevPAR markets show substantially weaker per-room tax productivity. Marina, despite the highest TOT rate at 14.0%, generates only $6,625 per room, 48% below Carmel, while Seaside produces just $6,165 per room at a 12.0% rate, 59% below Carmel. The data suggests that raising TOT rates does not compensate for weaker demand fundamentals and may, in fact, reflect structural limitations in pricing power rather than a viable revenue-maximization strategy. The most fiscally efficient jurisdictions remain those that protect rate competitiveness while sustaining strong lodging economics.

Exhibit B

Case Study - City of Half Moon Bay vs. Carmel-by-the-Sea

		FY 2021		FY 2022		FY 2023		FY 2024
City of Carmel-by-the-Sea								
Rooms		1002		948		899		973
TOT Rate		10%		10%		10%		10%
TOT Rev	$	5,106,437	$	8,267,748	$	7,454,146	$	8,347,682
TOT Rev/Rm	$	5,096	$	8,721	$	8,292	$	8,579
RevPAR	$	139.62	$	238.94	$	227.17	$	235.05
City of Half Moon Bay								
Rooms		650		650		650		650
TOT Rate		12%		14%		15%		15%
TOT Rev	$	4,817,532	$	9,442,518	$	8,852,640	$	6,167,938
TOT Rev/Rm	$	7,412	$	14,527	$	13,619	$	9,489
RevPAR	$	169.21	$	284.28	$	248.76	$	173.32



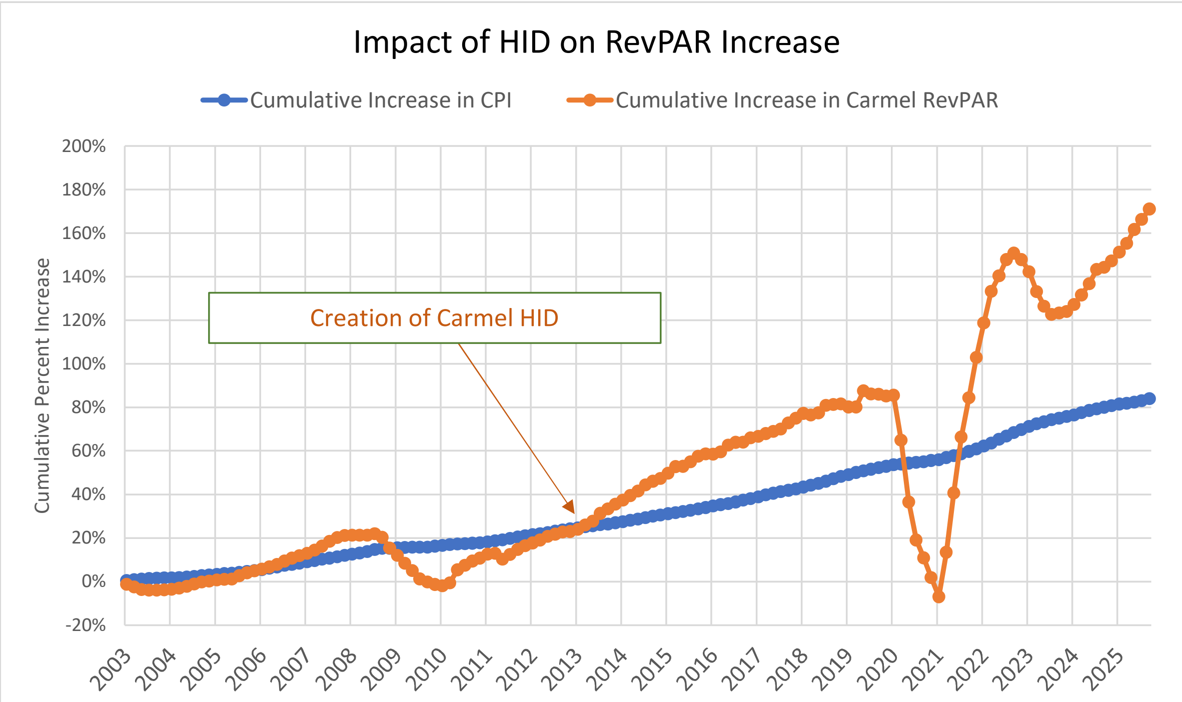
This case study shows that while Half Moon Bay's higher TOT rates initially produced stronger per-room tax revenues during the post-pandemic demand surge, those gains were not sustained as market conditions normalized. From FY 2021 through FY 2023, Half Moon Bay increased its TOT rate from 12% to 15% and generated materially higher TOT revenue per room than Carmel-by-the-Sea, supported by higher RevPAR in those years. However, by FY 2024, despite maintaining a 15% TOT rate, Half Moon Bay experienced a sharp decline in RevPAR to $173.32 and a corresponding drop in TOT revenue per room to $9,489, while Carmel, with a stable 10% TOT rate, achieved a higher RevPAR of $235.05 and nearly matched Half Moon Bay's per-room TOT production at $8,579. The data suggests that higher tax rates amplified revenues during peak demand but did not protect against downturns, whereas Carmel's lower, stable rate coincided with more consistent lodging performance and steadier TOT outcomes over time.

Exhibit C

Carmel Hotel RevPAR vs CPI

Cumulative, 2003 to Sep-Oct-2025

	Carmel RevPAR	CPI	Delta
Avg 12-Month RevPAR Incr. since HID (2013)	8.5%	3.8%	+123%
Avg 12-Month RevPAR Increase 2002 to 2012	2.3%	2.4%	(-5%)



Summary

Since the HID's creation in 2013, average annual RevPAR growth has exceeded inflation. The period analyzed includes significant market disruptions, most notably the COVID-19 downturn and recovery, as well as a multi-year period in which a substantial number of hotel rooms were temporarily out of service due to renovation, particularly from 2021 through 2023. These factors materially constrained both demand and available room inventory, preventing revenue from following a smooth or continuously realized growth path.

The growth rates used here represent period-average annual changes across the full 2013–October 2025 interval. Applying CPI-equivalent growth of 3.8 percent to the City's 2012 TOT base implies approximately $7.0 million in annual TOT by 2025. Applying the 8.5 percent RevPAR-based average implies approximately $12.5 million. This higher figure should be understood as an illustrative counterfactual rather than an observed outcome, as pandemic-related demand disruption and temporary inventory reductions limited the amount of taxable room revenue that could actually be generated in certain years.

The difference between these scenarios, approximately $5.4 million annually, illustrates the scale of incremental TOT revenue implied by post-2013 lodging revenue performance relative to an inflation-level baseline, while acknowledging that real-world disruptions prevented that level from being fully realized in every year.

Exhibit D

Price Elasticity of Demand of Hotel Rooms and TOT Increase

From UMASS Study: https://scholarworks.umass.edu/cgi/viewcontent.cgi?article=1291&context=jhfm

Price Elasticity of Demand = % Change in Quantity Demanded / % Change in Price

Upscale Hotels	-0.75		
Luxury Hotels	-1.36		
Price Increase via TOT Increase	**2%**		
Expected % Change in Quantity Demanded	Demand	Inventory	ADR
Upscale Hotels	-1.5%	55%	275
Luxury Hotels	-2.7%	45%	511

	12-Months Ended October 2025*
City of Carmel TOT	$ 9,527,836
City of Carmel Room Nights	244,932
TOT per Room Night	$ 38.90
Occupancy	69.2%
ADR	$ 381.00

Year 1 Expected Reduction in Room Nights	Demand Lost	Hotel Revenue Lost	Retail Revenue Lost
Upscale Hotels	(2,021)	$ (555,775)	
Luxury Hotels	(2,998)	$ (1,530,646)	
Total	(5,019)	$ (2,086,421)	$ (1,521,081)
Year 1 Lost Tax Revenues from Demand Reduction		(208,642)	$ (140,700)

Resultant TOT @10%	$ 9,319,194
Increase in TOT from Rate Increase (2%)	$ 1,863,839
Reduction in Sales Tax Revenues	$ (140,700)
Effective Net Tax Revenue Increase	$ 1,723,139

Overview

An increase in the Transient Occupancy Tax effectively raises the total price paid by overnight visitors. Hospitality economics research indicates that increases in room prices result in measurable reductions in demand, particularly in upscale and luxury lodging markets. Applying widely cited elasticity estimates, a 2 percent increase in the effective room price is projected to reduce annual occupied room-nights by approximately 5,000.

While the higher tax rate would increase City TOT revenues on remaining demand, the reduction in room-nights would result in an estimated $2.1 million annual loss in hotel room revenue. Reduced overnight visitation also affects local restaurants and retailers. Using tourism-economics methodologies commonly applied by Dean Runyan Associates, which attribute a majority of local sales tax generation to overnight visitors in tourism-dependent communities, the associated reduction in visitor spending is estimated to result in approximately $1.5 million in lost merchant revenue and a corresponding decline in sales tax receipts.

Over time, a higher TOT rate also captures a larger share of future visitor spending growth. If visitor spending increases at approximately 4 percent annually, a 2 percent increase in the TOT rate allocates a significant portion of that growth to the City while constraining hotel revenue growth relative to operating cost increases such as labor, insurance, utilities, and maintenance.

In aggregate, the analysis indicates that while a TOT increase may improve short-term City revenues, it is accompanied by quantifiable reductions in lodging demand, visitor spending, and sales tax generation, as well as longer-term implications for hotel reinvestment and employment.