

CITY OF SANTA ROSA
CITY COUNCIL

TO: MAYOR AND CITY COUNCIL
SUBJECT: FEES – COMMUNITY DEVELOPMENT DEPARTMENT
STAFF PRESENTER: CHUCK REGALIA, DIRECTOR
COMMUNITY DEVELOPMENT

AGENDA ACTION: MOTION

ISSUE(S)

Should the City Council initiate public review of the *Full Cost of Services Study for the Community Development Department*, and should the City Council consider reducing the amount of subsidy to private development applications by increasing development-related fees to more fully recover costs?



COUNCIL GOALS AND STRATEGIES

This program relates to Goal #1 Create a Strong Sustainable Economic Base and Goal #2 Promote a City Organization that is Sustainable and Maintains Employee Morale, Productivity and Effectiveness.

BACKGROUND

1. Recovery of costs for development review activities has been a consideration in Santa Rosa since 2004. At that time, the City Council approved financial principles to guide development fee cost recovery. Prior to that time, fees charged for services were relatively insignificant as compared to General Fund subsidy of development services.

On June 29, 2004, the City Council, by motion, approved Financial Principles that established guidance regarding cost recovery for development services. One of the approved Financial Principles states:

For all services determined to be “development-related,” a cost recovery level of 100% is desired.

2. On October 5, 2004, the City Council adopted Resolution 26099 relating to certain development review fee increases for the Department of Community Development and the Fire Department. Fees were adjusted for development-related applications.

Fire plan review and inspection were charged at 50% of the applicable building permit fee.

3. While these updated fees were intended to recover 100% of the cost to provide development review service, the City Council purposefully set certain fees, like the appeal fee, at a reduced (subsidized) rate so as to not discourage citizen participation.

The Council also directed that development-related fees be adjusted annually to reflect changes in the Consumer Price Index (Bureau of Labor Statistics San Francisco/Oakland/San Jose Consumer Price Index – All Urban Consumers - CPI-U). This adjustment occurs annually in July. The adjusted fees went into effect on January 1, 2005.

4. On August 5, 2008, the City Council adopted Resolution 27184 making adjustments to existing fees. Changes made with this Council action included: subsidizing homeowner landmark alteration fees, adopting fees for reprocessing development applications, and instituting fees to support advance planning and department technology needs.

Between August of 2008 and the present, adjustment of development fees have only occurred with the annual index update. For most of the intervening years, cost recovery has been low, due to economic conditions.

5. In 2009, the City initially engaged Wohlford Consulting to analyze the costs of development-related services. Work on this study, however, was postponed until the number of staff positions and the volume of development-related services achieved a consistent level after significant budget and staffing reductions took place in response to the economy. In April of 2013, this work was complete and the *Full Cost of Services Study for the Community Development Department* was submitted.

The purpose of this study is to identify the full costs incurred by the City in support of development review activities and to assist the City in the conversion of the Building Division's current system of valuation-based fees to a system of cost-based fees.

The purpose of this City Council discussion, therefore, is to:

- Initiate public review of the *Full Cost of Services Study*;
- Review current levels of subsidy of development-related services;
- Begin deliberations regarding development-related fees and recovery of development-related costs;
- Adopt a review schedule during which staff will meet with development review customers; and

- Set a public hearing to consider development-related fees for November 5, 2013.

ANALYSIS

- 1. Study Concept** – The basic concept of the *Full Cost of Services Study for the Community Development Department* is to determine the full cost of each individual service provided by the development-related departments for which the City charges a fee for services. The full cost may not necessarily become the City's fee, but it serves as the objective basis upon which the City Council can make informed decisions regarding the final fee level.

In order to determine the full cost for each service and provide a basis for the City to establish full cost recovery, if so desired, the cost analysis incorporates the following “full cost” components:

- Direct Salaries & Benefits
- Services and Supplies
- Indirect Activities
- Supervision and Support
- Cross-Department Support
- Department Administration
- Citywide Administration (Cost Allocation Plan)
- Facility Use
- Capital (annualized)
- Anticipated Growth

One of the critical methods to ensure full cost recovery rates is to establish annual billable (productive / available) hours for staff. The study reduced the full-time annual hours (2,080) for each position classification by the non-billable hours, such as holiday, vacation, sick leave and training. With this adjustment, the typical number of billable hours for the average full-time employee is approximately 1,400 hours per year, but this figure can range from 1,200 to 1,500, depending on the type of position.

In order to ensure accuracy and establish a clear nexus between the cost of services and the fees, the study utilized a unit cost build-up methodology to identify the full cost for individual fee activities.

In using this methodology, costs are “built up” for each individual service (unit) by determining the direct staff costs (time estimate x salary & benefits hourly rate) and then including a proportionate share of services and supplies, overhead, and support costs. In this way, only the costs that are associated with each individual service are included.

By using only the actual number of billable hours per employee, the study ensures that hourly rates and the resultant costs reflect the levels necessary to recover the full cost of services in a particular year given the practical availability of staff to provide services.

For more details regarding study methodology, please consult the full report.

- 2. Study Findings – Cost of Development Review Activities** – The basic finding of the *Full Cost of Services Study* is that the current full cost of City development-related activities is approximately \$5.0 million annually. Given the current fee levels charged by the City, there is a current annual deficit of approximately \$2.4 million as a result of the current cost-recovery ratio of 52% overall. This also means that the General Fund is currently subsidizing \$2.4 million or 48% of the City's development review services.

At a cost recovery rate of 52%, the City collects about \$2.6 million in annual revenue. If the City set fee levels at the full cost of each service (100% cost recovery rate) and the number of development-related services remained the same, the City could collect an additional \$2.4 million in revenue. The following table shows a summary of the study results:

Summary Results for Community Development Department

Department/ Division	FULL COST: Annual Cost of Fee- Related Services	POTENTIAL CURRENT COST RECOVERY: Projected Revenue @ Current Fees	CURRENT SURPLUS / (DEFICIT): (Full Cost- Current)	CURRENT COST RECOVERY RATE (Current/Full Cost)
Building Division	\$1,958,000	\$1,385,000	(\$573,000)	71%
Planning Division	\$3,071,000	\$1,240,000	(\$1,831,000)	40%
TOTALS:	\$5,029,000	\$2,625,000	(\$2,404,000)	52%

The details and explanations behind these summary figures are included within the body and appendices of the Full Cost of Services Study. The comprehensive data analysis for the Full Cost of Services Study was provided to the City Council and is available for review.

- 3. Costs - Building Division** – Within the Building Division, there are three general fee categories: New Construction, Miscellaneous Items and Mechanical, Plumbing &

Electrical items. The cost analysis of the Building Division revealed an overall annual funding *deficit* of approximately \$573,000 for fee-related activities, with an overall cost-recovery rate of 71%. Within the Building Division, the General Fund is subsidizing 29% of these development review activities.

Summary Results for the Building Division

FEE CATEGORY	FULL COST: Annual Cost of Fee- Related Services	POTENTIAL CURRENT COST RECOVERY: Projected Revenue @ Current Fees	SURPLUS / (DEFICIT): (Full Cost- Current)	COST RECOVERY RATE (Current/Full Cost)
New Construction Occupancies	\$1,445,000	\$829,000	(\$616,000)	57%
Miscellaneous Items	\$407,000	\$501,000	\$94,000	123%
Mechanical, Plumbing & Electrical Items	\$105,000	\$55,000	(\$50,000)	52%
Total:	\$1,957,000	\$1,385,000	(\$573,000)	71%

(Figures may not appear to calculate perfectly, due to rounding.)

In the **New Construction** category, the cost analysis revealed that 71% (488 / 690) of the current fees for plan check and inspection combined are less than the full cost of providing the services thus providing a subsidy to fee payers. The remaining fees (29%) are currently set equal to or higher than full cost, resulting in an annual surplus of revenue for those individual fees.

In the **Miscellaneous Fee** category, a slight majority of permits (56% or 76/136) are currently under-charged. The remaining permits (44%) are currently set at a level that over-recovers the full cost of providing the services. This over-recovery is particularly evident for re-roofing and residential remodels. Because of this over-recovery, adjustments will be made to insure that only the cost for the service is recovered.

For **Mechanical, Plumbing, and Electrical fees (MPEs)**, the majority (66%) of current permits are set at a level that under-recovers the full cost of service. The annual volumes apply sufficiently to the under-charged fees to create potential new revenues of \$50,000 at full-cost-recovery fee levels.

The Building Division has fee revenue deficits (subsidized) for New Construction and MPEs, and a surplus for miscellaneous fees. The overall result, however, is a total deficit of \$573,000 or 29%. Setting all fees at the full cost-recovery level would result

in some fee decreases, but mostly fee increases, and an overall annual increase of \$573,000 in fee revenue.

The majority of current Building Division fees are based on the valuation of the project for which a building permit is being requested. This is a traditional system that is not based on the actual cost. The *Full Cost of Services Study* has determined the actual cost to provide these services and with this update, it is proposed to convert current fees to a system of cost-based fees.

This conversion will result in a more rational basis for the fees charged and is intended to be more legally defensible.

- 4. Costs – Planning Division** – The Planning Division fees predominantly consist of flat (fixed) fees. For most services staff could identify a typical or standard project, with only slight variability of staff effort (i.e., cost) between similar projects, which allowed the study to establish fixed costs.

The costs included in this analysis include the cost of Planning personnel, as well as the direct service contributions from staff budgeted in other departments, such as Fire, Public Works, Police, Parks, and Transit.

Summary Results for the Planning Division

FULL COST: Annual Cost of Fee-Related Services	CURRENT COST RECOVERY: Projected (annual) @ Current Fees	CURRENT SURPLUS / (DEFICIT): (Full Cost-Current)	CURRENT COST RECOVERY RATE (Current/Full Cost)
\$3,071,000	\$1,240,000	(\$1,831,000)	40%

The cost analysis revealed that 92% (115 / 125) of the individual current fees in the Planning Division are less than the full cost for the service. Other findings include:

- 70% of the fees recover less than 50% of full cost.
- 53% of the fees recover less than 25% of full cost.
- 12% of the fees recover between 50% and 75% of full cost.
- 18% of the fees recover greater than 75% of full cost.
- 12% of the fees recover greater than 90% of full cost.

All fee-based development-related Planning activities, with few exceptions, are being subsidized by the City at varying rates, with roughly 70% of the activities receiving a General Fund subsidy of 50% or more. Comprehensively, with fee-based activities combined with non-fee activities, the overall average subsidy for Planning fee-based activities is 60%.

The overall result is that the current fee structure for Planning under-recovers the cost of providing the services and creates an annual funding deficit for the City of approximately \$1.8 million (subsidy paid by the fee payers through the General Fund) and an overall cost-recovery rate of 40%.

- 5. User Fees** – In the context of development-related fees, a *User Fee* is a fee or rate charged to an individual or group that receives a *private benefit* from services provided by the City. The general principle outlined in the *Full Cost of Services Study* is that individuals or groups that receive a purely private benefit should pay 100% of the full cost of the services. In contrast, services that provide a purely public benefit should be funded by tax dollars. User fees differ from Impact fees in that, the fee is for a specific service while impact fees address infrastructure needs resulting from development.

In Santa Rosa, while most development review activities are associated with a user or service fee, there are several essential services that are offered to the public at no cost. In many cases, these types of services precede the submittal of fee-based activities, or support important decisions regarding private property in the City.

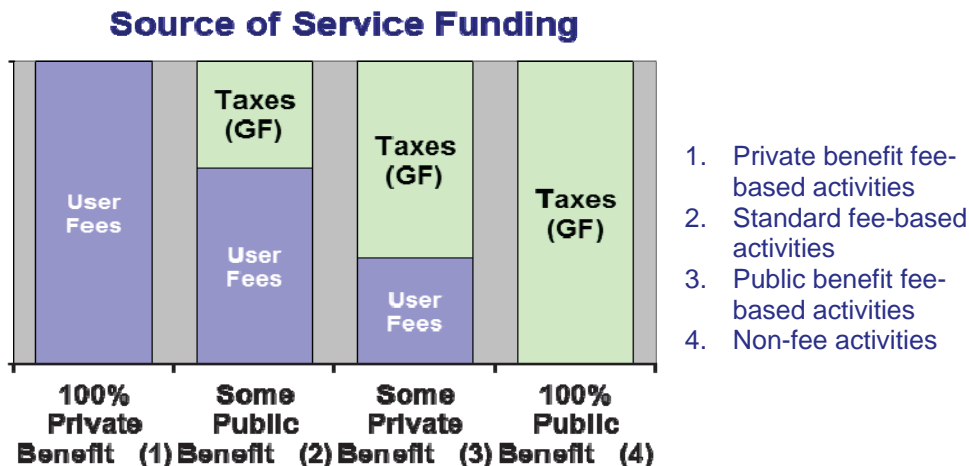
The public benefit to the City is in having informed citizens and applicants, increased compliance with adopted policies, verification of zoning prior to building occupancy, more complete applications, and review of public policy initiated by the City Council. Examples of current non-fee activities include:

- Responding to questions from the public about the City's Zoning and General Plan policies, about the permit review process, about Building and Fire Codes and about the City's fees;
- Pre-application meetings with potential developers, applicants and interested citizens;
- Issuance of over-the-counter zoning clearances, design review permits;
- General Plan and Zoning Code updates; and
- Policy review initiated by the City Council.

In contrast to the services discussed above where no fees are charged for certain activities, there are some services where the benefits are exclusively private, where little or no public benefit can be expected, and where there should be little or no subsidy offered by the City. In addition, some of these applications currently have high subsidy levels. Examples include the following:

- Vacations of Right-of-Way (summary and standard);
- General Plan Amendments (text and diagram), related Zoning Amendments;
- Development Agreements;
- Environmental Assessment; and
- Public hearing hard costs (e.g., mail postage, newspaper notices).

Regardless of the intent, however, it is important to understand that any subsidy granted must be covered by another revenue source, such as the General Fund. Therefore, the general taxpayer who will potentially help to fund private benefits, and/or other City services will not receive funds that are otherwise directed to cover subsidies. The following graphic illustrates the potential decision basis:



6. Potential Revenue and Fee Increase Scenarios – The following charts illustrate current fees and recovery levels and potential Building and Planning revenue under several cost recovery options, or levels of subsidy.

Standard Building Activity (*includes \$57 processing fee)	Current Fee	Current Fee cost recovery %	Fee at 75% cost recovery	Fee at 85% cost recovery	Fee at 100% cost recovery
Single Family Custom 2,500 sqft	\$2,825	69%	\$3,088	\$3,499	\$4,117
Single Family Production 2,000 sqft	\$2,397	139%	\$1,298	\$1,471	\$1,730
SFD Addition 500 sqft	\$1,029	51%	\$1,505	\$1,705	\$2,006
Multifamily Res. Complete 7,500 sqft	\$6,110	81%	\$5,663	\$6,418	\$7,551
Office T.I. 4,000 sqft	\$3,359	61%	\$4,145	\$4,697	\$5,526
Restaurant T.I. 5,000 sqft	\$4,777	81%	\$4,411	\$4,999	\$5,881
Residential garage 800 sqft	\$594	33%	\$1,367	\$1,550	\$1,823
Residential photovoltaic*	\$208	103%	\$151	\$171	\$202
Reroof less than 3,000 sqft*	\$227	100%	\$171	\$194	\$228

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Replace water heater*	\$65	54%	\$90	\$102	\$119
Electrical service upgrade 200 amp*	\$87	73%	\$90	\$102	\$119
Replace furnace*	\$77	65%	\$90	\$102	\$119

The examples above are representative of permits types in building. Some basic conclusions are as follows:

- 2 of 12 exceed 100% of cost and would need to be reduced;
- 3 of 12 recover about 50%, under the average of 71%;
- 7 of 12 are in the range of 60 – 80% cost recovery; and
- All building permitting includes the highest level of private benefit.

Standard Planning Activity	Currnt Fee	Current Fee cost recovery %	Fee at 60% cost recovery	Fee at 65% cost recovery	Fee at 75% cost recovery	Fee at 85% cost recovery	Fee at 100% cost recovery
Major Conditional Use Permit	\$12,512	93%	\$8,113	\$8,789	\$10,142	\$11,494	\$13,522
Minor Conditional Use Permit	\$2,572	83%	\$1,858	\$2,013	\$2,323	\$2,632	\$3,097
Major Design Review	\$9,493	51%	\$11,272	\$12,211	\$14,090	\$15,968	\$18,786
Minor Design Review	\$1,525	43%	\$2,151	\$2,330	\$2,689	\$3,047	\$3,585
Major Hillside Development	\$5,461	50%	\$6,497	\$7,038	\$8,121	\$9,204	\$10,828
Minor Hillside Development	\$1,872	29%	\$3,939	\$4,267	\$4,924	\$5,580	\$6,565
Major Subdivision	\$15,134	42%	\$21,721	\$23,531	\$27,151	\$30,771	\$36,201
Rezoning-Map Amendment	\$6,877	47%	\$8,842	\$9,578	\$11,052	\$12,526	\$14,736

Annexation	\$7,673	48%	\$9,606	\$10,407	\$12,008	\$13,609	\$16,010
Environmental Assessment MND*	\$2,399	23%	\$6,320	\$6,846	\$7,900	\$8,953	\$10,533

*Mitigated Negative Declaration

The examples above are representative of permit types in Planning. Some basic conclusions are as follows:

- 8 of 10 recover 50% of costs or less; most of these have significant private benefit; and
- At least one application type, environmental assessment, is mostly private benefit. It is necessary with most entitlement applications and the current cost recovery for this activity is 23%, with a 77% subsidy.

7. Options for Fee Adjustment – Reduction of Subsidy – Prior to consideration of fee adjustments or reduction of subsidy amounts, it should be noted that Santa Rosa has taken numerous actions to reduce staff costs and improve service levels. The City has streamlined the development review process by significantly increasing the number of uses permitted by right and has reduced the number of major and minor conditional use permits required.

The effect of these changes has been to reduce required entitlement applications, reducing the fee burden, saving applicant time and increasing certainty in the development review process.

In addition to cost savings and process streamlining, since 2008, the City has only made indexed adjustments to levels of fees for development services. Because of the serious economic conditions over the last five years, no major fee adjustments have been made. The chart below identifies changes in the Consumer Price Index selected to adjust City fees for service.

Year	CPI-U - Consumer Price Index
2013	2.4%
2012	2.1%
2011	2.8%
2010	1.7%
2009	0.8%
5-Year Average:	1.96%

With the completion of the *Full Cost of Services Study*, it has been demonstrated that there is an annual development review deficit of approximately \$2.4 million as a

result of the current cost-recovery ratio of 52% overall. This indicates that the General Fund is subsidizing \$2.4 million or 48% of the City's development services each year.

At this level of public subsidy for private development applications, it is evident that fees for many development review activities are too low and should be adjusted to increase fees and to reduced levels of subsidy.

Below are several options for City Council consideration. *The Full Cost of Services Study* includes these and other options as well.

Option 1: Adopt the Fee Schedule at 100% Cost-Recovery – The *Full Cost of Services Study* has identified the full cost of providing development review services, as well as the extent of current rate of cost recovery. This nexus report would support increasing fees to fund the full cost of services or at rates lower than full cost recovery.

This approach would result in the maximum cost recovery (i.e., new revenue gains), absent any reduction in the number of applications (which is unknown), and it is the only approach that will mitigate the underfunding of department services. Increasing fees to 100% cost recovery levels would be consistent with previous Council direction. Fee levels set at full cost recovery, however, may increase the likelihood that certain customers will avoid applying for the necessary permits.

Option 2: Standard Discount – If the City Council determines that adjusting fees to full cost recovery levels may be too much given the nature of the economy, or that full cost recovery for all services is not appropriate, a workable option is to apply a standard discount to the cost results.

For example, the City Council could decide to charge a specified percentage (e.g., 85%) of full cost for all fees. Under this scenario, the City would increase fees that are currently less than the specified percentage of full cost and decrease any fees that are currently greater than that percentage.

Although the cost recovery rate would be standardized, the rate of change for individual fees would be inconsistent, to the extent that these fees are not currently set at a consistent ratio to full cost. As a result, the fee payers could still experience significant percentage and/or dollar increases to individual fees.

Option 3: Increase Selected Fees Only – The City Council could choose to select only a limited number of fees to increase. To select the fees targeted for increase, the City should consider a variety of factors that affect progress towards current revenue, subsidy, or policy goals. These factors can include fees which are unduly burdensome to customers, fees which are the least successful at current cost recovery (i.e., most subsidized), and fees which have the most private benefit.

While this approach will cause a sub-optimal recovery of full cost and facilitate continued subsidization of development review Department services, after further review, it may a practical option.

Option 4: No Change – The City Council could decide that, due to external factors, like the economy, fees should remain the same and not be increased. While this approach would keep fees the same for payers, this approach would not change the Building Division’s valuation-based system to a cost-based system, it would not make progress toward reducing subsidies and increasing revenue and any fee currently set at a rate higher than the cost to provide that service will need to be reduced.

Option 5: Phased Implementation – Under this approach, the City Council would select a period of years over which to achieve its overall goals. For example, the City could decide to achieve full cost recovery over a period of two, three or four years, rather than all in the first year. To achieve a “full cost in four years” goal, the City would increase the fees by 25% of the gap between current fees and full cost (25% of the deficit) each year. To achieve the gap within two or three years the fees would be increased by 50% or 33% of the deficit each year.

While phased implementation can apply to all fee options, if increases are phased over time, the City Council should also consider including the annual inflation (Index rate increases) in the annual phased growth factors, to ensure that full cost is included for the duration of the phasing.

This approach would smooth out the fee increases, which might allow customers to adjust their expectations, plan for future development projects, absorb the increases over time, and build the increases into their cost calculations. This approach may also stimulate some development activity, as customers schedule their projects earlier to take advantage of reduced fees. However, this approach will also maintain a level of deficit for a longer duration and perpetuate the underfunding of services.

Option 6: Hybrid Approach – The City has the option to mix and match the components of each option to establish a process and an outcome that best meets Santa Rosa’s needs. For example, the City Council could consider various fee structures and set different fee structures for each. In addition the Council may consider increasing service fees annually and over time. Standard fee-based activities, for example, could increase initially to a cost recovery rate and then be increased to the ultimate cost recovery goal at a time specified by the City Council. In addition, the Council could move certain fees to 100% full cost recovery and keep others at a more subsidized rate.

Proposed Approach – Following initial City Council review, it is necessary that the City’s private and public customers of the development-related departments review the Cost Study and potential fee increases. To accomplish this, the City Council

should initiate this review by establishing a 45-day review period, during which time a public hearing will be conducted before the City Council.

Staff suggests that the City Council consider the following direction regarding the public review process and potential changes to development-related fees and subsidies:

- A. Initiate a 45-day public review period; schedule a City Council public hearing for November 5, 2013;
- B. Schedule review time with builders, developers, and associations representing these groups; talk to neighborhood groups, non-profit builders and business groups with an interest in user fees;
- C. Direct that no fee be higher than the cost to provide services;
- D. Direct that the Building Division valuation-based fees be changed to cost-based fees;
- E. Examine current fee subsidies to determine fees which should continue to be subsidized and fees which should be added to this category; determine which fees should not be subsidized;
- F. Determine which fees, because of the extent of private benefit, should be potentially increased to 100% cost recovery; and
- G. Determine the feasibility of increasing overall cost recovery rates for Development Review Services; examine increases to achieve the following recovery goals:
 - 1. 100% cost recovery;
 - 2. 85% cost recovery;
 - 3. 75% cost recovery; and/or
 - 4. Other

RECOMMENDATION

It is recommended by the Community Development Department that the Council, by motion, accept the *Full Cost of Services Study for the Community Development Department*, initiate a 45-day public review period for a potential fee increase, provide any Council direction for consideration during public review, and schedule a public hearing before the City Council for November 5, 2013.

Author: Chuck Regalia

Attachments:

- *Full Cost of Services Study for the Community Development Department*