



REPORT TO CITY COUNCIL

To: Honorable Mayor and Members of the City Council

From: Grant Yates, City Manager

Prepared by: Jason Simpson, Assistant City Manager

Date: June 12, 2018

Subject: Adopt User Fees and Cost Allocation Plan (Continued Public Hearing)

Recommendation

adopt A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF LAKE ELSINORE, CALIFORNIA, ADOPTING THE USER FEES AND COST ALLOCATION PLAN

Background

The City of Lake Elsinore engaged Willdan Financial Services (Willdan) to determine the full costs incurred by the City to support the various activities for which the City charges user fees. Due to the complexity and the breadth of performing a comprehensive review of fees, Willdan employed a variety of fee methodologies to identify the full costs of individual fee and program activities. This report and the appendices herein identifies 100% full cost recovery for City services and the recommended level of recovery as determined through discussion with departmental staff. The reality of the local government fee environment is that significant increases to achieve 100% cost recovery can often not be feasible, desirable, or appropriate depending on policy direction, particularly in a single year. The recommended fees identified herein are either at or less than full cost recovery.

Discussion

A Cost Allocation Plan is a comprehensive study to determine the fair and equitable allocation of the cost of City's central administrative functions; City Administration, Finance, Human Resources, City Clerk and City Attorney. The study will analyze each individual function, determine its cost and develop the appropriate allocation bases necessary to distribute costs to the receiving operating departments within the City. The City currently does not employ a Cost Allocation Plan to spread administrative costs.

A User Fee Study is conducted to accurately, fairly and reasonably determine the full cost for City departments to provide services to the individuals and businesses within the community, such as plan check, inspection, permitting and other development-related services. As part of a general cost recovery strategy, local governments adopt user fees to fund programs and services that provide limited or no direct benefit to the community as a whole. As cities struggle

to maintain levels of service and variability of demand, they have become increasingly aware of subsidies provided by the General Fund and have implemented cost-recovery targets.

Unlike most revenue sources, cities have more control over the level of user fees they charge to recover costs, or the subsidies they can institute. The recent trend for municipalities is to update their fee schedules to reflect the actual costs of certain public services primarily benefitting users. User Fees recover costs associated with the provision of specific services benefitting the user, thereby reducing the use of General Fund monies for such purposes. In addition to collecting, the direct cost of labor and materials associated with processing and administering user services, it is common for local governments to recover support costs. Support costs are those costs relating to a local government's central service departments that are properly allocable to the local government's operating departments. Central services support cost allocations were derived from the City's Cost Allocation Plan. As labor effort and costs associated with the provision of services fluctuate over time, a significant element in the development of any fee schedule is that it has the flexibility to remain current.

Therefore, it is recommended that the City include an inflationary factor in the resolution adopting the fee schedule to allow the City Council, by resolution, to annually increase or decrease the fees. The most commonly used inflator is the Consumer Price Index (CPI) as it is widely well known and accepted. It is also recommended that every three to five years a comprehensive review of the models utilized to develop the Cost Allocation Plan and User Fee Study be reviewed, modified and updated as appropriate. These comprehensive studies should be conducted to identify direct and indirect costs to ensure the City is not overcharging for services in compliance with Proposition 218, as well as Government Code 66016; or undercharging for services rendered. Additionally, an approved Cost Allocation Plan is required in order to allocate overhead costs to projects/programs, which are Federal and/or State grant funded.

Building Department Fees - Residential

The study also included a comprehensive review of building department user fees and staff is proposing to combine mechanical, plumbing, and electrical permits fees (MPE) into a flat fee amount based upon typical 2,805 sq. ft. single-family residence (SFR) to streamline the issuance of the permit. In addition, a fee methodology establishing fees for new development tract homes for both the model home as well as a separate calculation for production units within a development.

To illustrate the impact on costs to developers of new homes (SFR/MFR), the fee study suggested an 8.7% increase for full cost recovery. With the utilization of the MPE flat fee, the increase is approximately 3.4%. Furthermore, the Tract Model home fee represents a 3.4% increase, while production units will yield a 15.63% decrease over current building permit fees, primarily due to the elimination of the building plan check fee on production units (See Table 1 below and Exhibit D to this report).

Table 1

DESCRIPTION	PROPOSED FEES				
	CURRENT FEES	STUDY SUGGESTED FEES	NON-TRACT SFR FEES	MODEL HOME SFR FEES	PRODUCTION UNITS - TRACT HOMES SFR FEES
Total Building Permit Fees (SFR)	\$ 4,265.77	\$ 4,635.96	\$ 4,412.29	\$ 4,412.29	\$ 3,599.16
% Increase/(decrease) from Current Fees		8.68%	3.43%	3.43%	-15.63%

*Based upon a 2,805 sq ft single family residence example

Building Department Fees – Commercial

The study also included a comprehensive review of building department user fees and staff is proposing to combine mechanical, plumbing, and electrical permits fees (MPE) into a flat fee amount based upon \$.40 sq. ft. for a typical 2,805 sq. ft. commercial property development to streamline the issuance of the permit. To illustrate the impact on costs to developers of new commercial (See Table 2 below and Exhibit D to this report).

Table 2

DESCRIPTION	PROPOSED FEES		
	CURRENT FEES	STUDY SUGGESTED FEES	COMMERCIAL PERMIT FEES
Total Building Permit Fees (COMMERCIAL)	\$ 5,296.16	\$ 6,135.84	\$ 5,892.53
% Increase/(decrease) from Current Fees		15.85%	11.26%

*Based upon a 2,805 sq ft commercial property example

Building Industry Association, Riverside County Chapter (BIA)

City staff has met with Building Industry Association (BIA) representatives and responded to voluminous record requests under the Public Records Act (PRA) to listen to their concerns. They shared comments regarding the proposed update of building permit fees by the City of Lake Elsinore (City) as a result of the review documented in the Comprehensive User Fee Study Report (User Fee Study) prepared by Willdan Financial Services (Willdan), that forms the basis for the City's proposed update of building permit fees.

In general, the comments submitted by the BIA seek to challenge the methodology and calculations used by Willdan and the City to determine the proposed update of building permit fees. While the City issues dozens of various building permits, the BIA's comments are exclusively focused on the methodology and cost of building permits for single-family residences. The following is a summary of what appears to be the basic assertions and questions raised by the BIA:

1. The BIA asserts the City has collected net excess building permit revenue during the current and prior fiscal years;

City Staff comments: The following are some of the errors contained in BIA's analysis that lead to its incorrect assertion:

- The BIA begins with a baseline assumption that evidences a failure to understand the City's true cost of reviewing, issuing and inspecting building permits. The BIA erroneously assumes the annual expenses for the Building & Safety Department (including Fire Prevention services) should be equivalent to the annual building permit fee revenues, and that any positive difference demonstrates that excess building permit fee revenues were collected by the City. The primary error is the BIA's assumption the only expenses incurred by City when reviewing, issuing and inspecting building permits are the direct costs contained in the departmental expenses for Building & Safety and Fire Prevention services.

As explained in the User Fee Study (pp. 6 and 27), direct departmental costs (salaries, benefits and operating expenses) are only one component of calculating the City's cost to provide a municipal service. Other indirect cost components include city-wide overhead (costs associated with central services that support departmental operations such as administration, finance, human resources, legal, fleet, information technology, etc.), cross-departmental support (costs incurred by other departments/staff associated with review or assistance in providing the service), and off-budget items (additional capital costs associated with providing the service, such as technology acquisition, enhancement and replacement for building permit services). Each of these cost components are determined and calculated using a cost-allocation methodology commonly known and accepted as the "bottom-up" approach to establishing building permit fees. The result of these allocations provides detailed documentation of the City's reasonable estimate of the actual full cost of providing each service. The standard-unit cost build-up approach is widely utilized and accepted as industry-standard throughout cities and counties in California and across the nation.

Based on the foregoing, the BIA's misunderstanding of how building permit expenses are determined leads to flawed calculations and erroneous conclusions by the BIA that there have been over- or under-collections by the City for building permit fees in the current or prior fiscal years.

2. The BIA questions the City assigning fifty percent of the Community Development Director's time to work dealing with the Department of Building and Safety;
- **City Staff Comments:** As discussed in User Fee Study, in determining how to allocate employee time and City costs, Willdan conducted an extensive time and materials survey and review of City functions and employee activities, including receiving time estimates to complete tasks, staffing structures, direct and indirect work hours and other pertinent information. One of the key study assumptions utilized in a "bottom up" approach to developing user fees is the use of time estimates for the provision of each fee related service. Utilization of time estimates is a reasonable and defensible approach, especially since these estimates are developed by experienced staff members who understand service levels and processes unique to the City. Also, given that the Community

Development Director oversees major functions with generally equivalent budgets and staffing (Planning & Zoning and Building & Safety for example), it is intuitively logical and rational that the Director's time would generally be split equally between the functions. The City's current year budget discusses this allocation which is based on the extensive data collection and analysis performed by Willdan in the User Fee Study. The BIA presents no data or evidence to the contrary.

3. The BIA asserts the City has over-estimated the hours required for building permit review, issuance and inspection services; and

- **City Staff Comments:** In an attempt to demonstrate the City has over-estimated the hours required for permit issuance and inspection services, the BIA attempts to construct a contorted correlation of employee hours with a combined Fully Burden Hourly Rate (FBHR) for all employees and building permit fee costs to derive an average number of hours required to review, issue and inspect a building permit for a single-family residence. The BIA then extrapolates this data to conclude a minimum departmental staffing required to annually provide building permit services.

The flaws in this attempted analysis are plentiful and we have limited our response to two critical areas. First, the BIA's analytical process once again utilizes the erroneous assumption of 2080 hours per employee (the study utilized 1,680 hours). Second, because the FBHR of employees are derived from a full-cost accounting of the service (see discussion under Section I), it's erroneous to use the FBHR to calculate staffing hours. The amount of an FBHR is calculated and established to ensure the City recovers all expense inputs for the service which are spread across a myriad of departments and employees, not just the employees providing the direct service.

4. The BIA asserts the City should employ a deposit-based system for building permit fees that requires all staff track and assign their time per project and permit.

- **City Staff Comments:** While the BIA is correct that some jurisdictions have sought to implement a deposit-based building permit fee process, many jurisdictions throughout the state and nation continue to establish and collect building permit fees based on time estimates and valuation tables. Typically, a deposit-based user fee is appropriate for services for which time and material estimates are difficult, or there is little correlation between the time and materials and project scale/size. As explained in the User Fee Study, for building permit services, not only are good time and material estimates available for various tasks, it also widely accepted that time and materials required for building permits correlate strongly with project valuation. In other words, project valuation is a good proxy for measuring the amount of time and materials required for the associated building permit review, issuance and inspection. The State of Oregon, in fact, mandates cities and counties use of the permit valuation methodology (see Oregon Administrative Rules s. 918-050-0100).

This strong correlation has been aided by the Building Valuation Data (BVD) Table produced and regularly updated by the International Code Council (ICC), which provides an average construction cost per square foot that can be used to scale base building permit fees. Use of the ICC's BVD is widely-accepted by jurisdictions throughout the state and nation as a reasonable and rationale basis for scaling building permit fees. The alternative methodology proposed by the BIA presents technological and management requirements, as well as additional costs, to ensure accurate time-keeping by every employee and continuing administration of the record-keeping and billing system.

The multiplier used is as follows:

DESCRIPTION		REF ID
Multiplier Used for the Study	0.02210358	A/B
Permit Valuation (Average Annual)	\$ 101,465,100	B
FY2016-17 Expenditure Budget	\$ 1,847,551	
Cost Allocation Plan obligation %	21.3900%	
FY2016-17 Fully Burdened Expenditure Budget	\$ 2,242,742	A
FY 2014 -17 Average Building Permit Revenue	\$ 1,761,553	C
Current Cost recovery	78.54461%	C/A
% of Building that should be recovered by Fees	100.0000%	
Revenue surplus/(deficiency)	\$ (481,189)	C - A
% fee change needed to obtain full cost recovery	27.3162%	(C-A)/C
% change applied to table	10.0000%	D
New cost recovery level	86.3991%	(C/A) x (1+ D)

The calculations support staff use of the multiplier and ICC valuation tables since the City's costs are not being fully recovered even after the study takes into account a 10% increase. Notwithstanding the analysis for full cost recovery including an applied 10% increase in the model, staff is proposing streamlining (no changes to initial approach) on building permits for residential which demonstrate decreases/reductions and fixed amounts as shown in the exhibit illustrated for an example 2,805 sq. ft single family unit (noted above). For other increases for the most was a blend approach department by department to step into getting full cost recovery including some that are full cost recovery.

Fiscal Impact

The user fee study and proposed rates and related fees represent a fair and reasonable fee structure with many fees not a full cost recovery, including focused review on building permit fees. The study will also adopt Consumer Price Index for All Urban Consumers- Los Angeles-Riverside-Orange County, CA (CPI) as of December of the preceding and made effective for July 1 each fiscal year allowing for automatic annual adjustments, including increases and decreases.

Exhibits

User Fee Study and Cost Allocation Plan

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- A Resolution
- A-1 Staff Proposed Fees Tables to Resolution
- B User Fee Study Report
- C Cost Allocation Plan
- D Building Permit Example
- E Letter to BIA