



Legislation Details (With Text)

**File #:** 19-104      **Version:** 1      **Name:**

**Type:** Study Session      **Status:** Agenda Ready

**File created:** 1/16/2019      **In control:** City Council and Authorities Concurrent

**On agenda:** 5/21/2019      **Final action:**

**Title:** Discussion and Review of User Fees for Cost of Services and Workplan to Evaluate User Fees

**Sponsors:**

**Indexes:**

**Code sections:**

**Attachments:** 1. Facility Rentals - Combined, 2. POST MEETING MATERIAL

Date	Ver.	Action By	Action	Result
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**REPORT TO COUNCIL**

**SUBJECT**

Discussion and Review of User Fees for Cost of Services and Workplan to Evaluate User Fees

**EXECUTIVE SUMMARY**

The purpose of this presentation is to inform the City Council (Council) of staff's efforts to advance the City's priorities to stabilize our fiscal outlook in order to preserve service and staffing levels, generate more revenue to meet expenditure growth demands, and develop strategies for unfunded needs/projects.

As part of the continuing budget stabilization work effort, staff has stated that there will need to be further analysis of revenue options in order to provide sustainable budget solutions to increase current revenue sources and/or identify new revenue sources to stabilize the City's future fiscal condition. Following are the revenue strategies that staff will be analyzing for Council consideration:

1. Increase in User Fees,
2. Increase in the Transient Occupancy Tax (TOT) rate,
3. Evaluate the feasibility for a Utility User Tax (UUT), and
4. Additional Council direction is required on whether to study a Business License Tax or any other type of Business Tax.

This study session will begin the policy work resulting from the Council directed Cost of Services Study. This study has identified the permit areas where the City is under-collecting the cost associated with providing services by approximately \$20 million. This known funding gap is, therefore, being subsidized by other City revenue sources and it is worth the City Council's deep review to determine whether it would like to continue with this level of subsidy.

Based on the information provided in this report, at a global or per unit level, staff requests policy direction from Council regarding fees that they wish to continue to subsidize, and at what level to set

cost recovery for remaining fees.

## **BACKGROUND**

On a periodic basis, it is incumbent upon government agencies to comprehensively evaluate and update their fee schedules in an effort to manage resources efficiently and meet service demands. In California, several constitutional provisions such as Propositions 13, 4, and 218, as well as State Government Codes 66014 and 66016, and more recently Prop 26 and the Attorney General's Opinion 92-506 set the parameters under which the user fees are established and administered. Applicable state law requires that any user fee charged by the City be "no more than necessary to cover the reasonable costs of the governmental activity" (Cal. Const. Art 13C §1).

Government agencies are allowed to set fees at rates to obtain fair and reasonable recovery of costs incurred in providing these services, thereby minimizing or eliminating the use of limited general tax revenues. Historically, the City has sought to maximize cost recovery through annual review and evaluation of fees that are set at appropriate levels to cover the escalating costs of doing business and that take market comparisons into consideration.

At the City Council Goal and Priority Setting Session held on January 31 and February 1, 2019, the Council adopted Budget Principles for the FY 2019/20 and FY 2020/21 Biennial Operating Budget. The Council adopted the following budget principle related to cost recovery for fees:

- With limited exceptions, establish fees based on full cost recovery where individuals/businesses rather than the community at-large are benefiting from City services. This preserves limited unrestricted resources for providing services that benefit the community as a whole.

The City's cost of service fees, also referred to as user fees, are a compilation of fees for City services provided to members of the public. These services generally do not rely on tax revenues, but are provided for the benefit of individual members of the public. The advantages of updating the City's user fees include assuring that fees are set based on current costs and approved cost recovery objectives while providing transparency in the fee structure for the City's development-related and other municipal fees. The last update to the fee schedule was approved by the Council on May 8, 2018.

In December 2018, the Council approved an agreement with Matrix Consulting Group (consultant) to develop a comprehensive Cost of Services Study (Study). The purpose of the Study is to evaluate current fees to determine the current level of cost recovery, as well as ensure compliance with local and state laws for user fees.

## **DISCUSSION**

The consultant analyzed the cost of service relationships that exist between fees for service activities in the following departments: City Clerk, Building, Housing, Planning, Electric Utility, Finance, Fire, Library, Parks and Recreation, Cemetery, Police, Engineering, Streets, and Water and Sewer Utility.

The results of this Study provide a tool for understanding current service levels, the cost and demand for those services, and what fees for service can and should be charged.

The methodology employed by the consultant is a widely accepted "bottom up" approach to cost analysis, where time spent per unit of fee activity is determined for each position within a Department

or Program. Once time spent for a fee activity is determined, all applicable City costs are then considered in the calculation of the “full” cost of providing each service.

The work accomplished by the consultant in the analysis of the proposed fees for service involved the following steps:

- **Departmental Staff Interviews:** The project team interviewed Departmental staff regarding their needs for clarification to the structure of existing fee items, or for addition of new fee items.
- **Data Collection:** Data was collected for each permit/service, including time estimates. In addition, all budgeted costs and staffing levels for FY 18/19 were entered into the consultant’s analytical software model.
- **Cost Analysis:** The full cost of providing each service included in the analysis was established. Cross-checks including allocation of not more than 100% of staff resources to both fee and non-fee related activities assured the validity of the data used in the Study.
- **Review and Approval of Results with City Staff:** Departments reviewed and approved these documented results.

When comparing the FY 18/19 fee related expenditures with fees generated in FY 17/18 it was determined that the City is under-recovering its costs by approximately \$20.5 million and recovering about 44% of its budgeted costs annually. The following table outlines these results on a departmental basis:

Table 1: User Fee Summary of Revenue, Cost, and Cost Recovery

Department	Revenue at Current Fee	Total Annual Cost	Annual Surplus/ (Deficit)	Cost Recovery %
<b>Phase One</b>				
City Clerk	\$31,970	\$33,920	(\$1,950)	94%
Housing & Community Services	\$28,520	\$37,844	(\$9,324)	75%
Finance	\$2,195,923	\$2,624,117	(\$428,194)	84%
Library	\$112,836	\$330,892	(\$218,056)	34%
Cemetery	\$222,026	\$361,224	(\$139,198)	61%
Recreation	\$2,604,667	\$15,053,849	(\$12,449,182)	17%
Police	\$38,185	\$61,278	(\$23,093)	62%
<b>Phase Two (Development-Related Fees)</b>				
Planning	\$1,220,544	\$3,038,661	(\$1,818,117)	40%
Fire	\$4,121,202	\$7,428,027	(\$3,306,825)	55%
Engineering	\$2,595,287	\$2,919,726	(\$324,439)	89%
Streets	\$301,602	\$729,461	(\$427,859)	41%
Water	\$2,353,777	\$3,490,818	(\$1,137,041)	67%
Sewer	\$58,132	\$252,773	(\$194,641)	23%
<b>Total</b>	<b>\$15,884,671</b>	<b>\$36,362,590</b>	<b>(\$20,477,919)</b>	<b>44%</b>

As the table indicates approximately \$12.5 million or 61% of the \$20.5 million subsidy is related to Recreation services. The next largest subsidy of \$3.3 million is related to the Fire Department.

There are programs, circumstances, and services that justify a subsidy from a tax based or alternative revenue source. However, it is essential that the Council prioritize the use of revenue sources for the provision of services based on the continuum of the benefit received.

The following factors are key policy considerations in setting fees at less than 100 percent of cost recovery:

- **Limitations posed by an external agency.** The State or an outside agency will occasionally set a maximum, minimum, or limit the jurisdiction’s ability to charge a fee at all. An example includes time spent copying and retrieving public documents for PRA responses.
- **Encouragement of desired behaviors.** Keeping fees for certain services below full cost recovery may provide better compliance from the community. For example, if the cost of a permit for changing a water heater in residential home is higher than the cost of the water heater itself, many citizens will avoid pulling the permit, which may lead to unsafe consequences.
- **Effect on demand for a particular service.** Sometimes raising the “price” charged for services might reduce the number of participants in a program. This is largely the case in Recreation programs such as camps or enrichment classes, where participants may compare the City’s fees to surrounding jurisdictions or other options for support activities.
- **Benefit received by user of the service and the community at large is mutual.** Many services that directly benefit a group or individual equally benefit the community as a whole. Examples include Recreation programs, Planning Design Review, historical dedications and certain types of special events.

The primary goals of a Cost of Services Study are to provide a fair and equitable basis for determining the costs of providing services, and assure that the City complies with State law. Once the full cost of providing services is known, the next step is to determine the “rate” or “price” for services at a level which is up to, and not more than, the full cost amount. The Council is responsible for this decision, which often becomes a question of balancing service levels and funding sources. However, with the resulting cost of services information from a Cost of Services Study, the Council can be assured that the adopted fee for service is reasonable, fair, and legal.

The following table outlines the cost recovery levels by major department compared to typical cost recovery levels based on the consultant’s experience in analyzing local government’s operations across the United States and in California:

Table 2: Summary of Typical Cost Recovery vs. Santa Clara Fees

Department	Typical Cost Recovery %	City of Santa Clara Current Cost Recovery %
City Clerk	20-40%	94%
Planning	50-80%	40%
Fire	50-80%	55%
Finance	20-40%	84%

Police	20-40%	62%
Public Works	80-100%	89%
Parks and Recreation	20-40%	17%

Historically, the City’s past practice based on Council direction was to increase fees by maximum increments of 25% to the extent that such increases did not exceed cost recovery. Staff is requesting Council review the past practice to determine if the 25% year-over-year maximum increase is still the approach the Council desires to utilize. For example, Fire Department User Fee - Light/Ordinary Hazard Occupancy Fee for a Home Business (one-time fee) is currently set at \$95 in the adopted FY 2018/19 Municipal Fee Schedule. The actual full cost recovery for the City to perform this service is \$168 therefore using the 25% incremental threshold does not achieve full cost recovery in a timely fashion since this fee would only increase by approximately \$24 for the upcoming year to \$119 (\$95 + \$24), which falls well below the full cost recovery level. The capped 25% increase Council direction is in direct conflict with the City Council’s Budget Principle relative to Cost Recovery.

As part of the Study, staff reevaluated the current fee items against the City’s overall business transactions, added new fees and eliminated redundant items. The following table outlines the number of fees deleted by department:

Table 3: Summary of Fees Proposed for Deletion

Department	Number of Deleted Fees
City Manager’s Office	4
Community Development - Planning	1
Electric	2
Finance	1
Fire	47
Library	1
Police	2
Public Works - Street	1
<b>Total</b>	<b>59</b>

The table below outlines the number of new fees by department:

Table 4: Summary of Fees Proposed for Addition

Department	Number of New Fees
<b>Phase I</b>	
Community Development - Housing & Community Services	7
Electric	2
Parks and Recreation	1
Police	5
<b>Phase II and III</b>	
Fire	10

Public Works - Engineering	12
Public Works - Street	1
Water & Sewer	16
<b>Total</b>	<b>54</b>

It should be noted that meeting room fees for the Council Chambers and Fire Department were deleted and it was determined that these rooms are not rented out to the general public.

Due to the magnitude of information presented in this Study and the need to allow staff with sufficient time to understand and absorb the data, as well as to allow for the necessary outreach to the development community, staff is recommending a workplan that includes a phased approach to adopting the updated user fees.

Phase I of the study will include the routine non-development related fee departments. Development related fees will be included in Phase II of the workplan and will allow for staff to have sufficient time to provide outreach and discussion with the development community. Phase III will include fees that were brought forward during the study but that required more time for the Consultant to review. The proposed workplan for the next few months is as follows:

**Phase I:**

- Citywide fees (copy fees, technology fee, media fee)
- City Clerk
- Housing and Community Services Division
- Electric
- Finance
- Library
- Cemetery
- Recreation
- Police
- Deleted fees
- New fees (Phase I departments)
- Over-recovery fees

**Phase II-Development related fees:**

- Building Division
- Planning Division
- Fire
- Public Works
- Water Utility
- Sewer Utility

**Phase III-areas that needed more time to be study:**

- Off-site Parking fee
- Electric Bike/Scooter fee
- False Alarm fee
- Massage Program fees
- Temporary Street Pole Banner permit

### **ENVIRONMENTAL REVIEW**

This is an informational report only and no action is being taken by the City Council. The information being considered does not constitute a “project” within the meaning of the California Environmental Quality Act (“CEQA”) pursuant to CEQA Guidelines section 15378(b)(4) in that it is a fiscal activity that does not involve any commitment to any specific project which may result in a potential significant impact on the environment.

### **FISCAL IMPACT**

There is no cost to the City associated with this report other than administrative time and expense. Pending the outcome of discussions on the findings and proposed changes set forth in the Study, any impact on the revenue will be updated in the FY 2019/20 Municipal Fee Schedule and reflected in the FY 2019/20 and FY 2020/21 Biennial Operating Budget.

### **COORDINATION**

This report has been coordinated with the City Manager’s Office.

### **PUBLIC CONTACT**

Public contact was made by posting the Council agenda on the City’s official-notice bulletin board outside City Hall Council Chambers. A complete agenda packet is available on the City’s website and in the City Clerk’s Office at least 72 hours prior to a Regular Meeting and 24 hours prior to a Special Meeting. A hard copy of any agenda report may be requested by contacting the City Clerk’s Office at (408) 615-2220, email [clerk@santaclaraca.gov](mailto:clerk@santaclaraca.gov) <<mailto:clerk@santaclaraca.gov>> or at the public information desk at any City of Santa Clara public library.

Reviewed by: Angela Kraetsch, Director of Finance

Approved by: Deanna J. Santana, City Manager