



ADMINISTRATIVE SERVICES DEPARTMENT

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CITY COUNCIL STAFF REPORT

Meeting: February 6, 2024

Subject

Cost Allocation Plan, User Fee Study, and Cost Recovery Policy

Recommended Action

Receive and File Cost Allocation Plan and User Fee Study and provide direction on the components of a Cost Recovery Policy

Reasons for Recommendation

A comprehensive Fee Study is completed in conjunction with a Cost Allocation Plan (CAP) in approximately seven-year cycles. The City last completed a fee study and CAP in 2016. The objective of the fee study is to re-evaluate time and cost assumptions and determine the full cost (direct and indirect) of providing City services based on the current organizational structure and processes. The intent of this item is to provide a review of the fee study and to obtain City Council direction towards further review and adoption of the fee schedule later this fiscal year.

Background

Local governments are providers of many types of general services to their communities. While all services provided by local government are beneficial to constituents, some services can be classified as globally beneficial to all citizens, while others provide more of a direct benefit to a specific group or individual. The following table provides examples of services provided by local government within a continuum of the degree of community benefit received:

“Global” Community Benefit	“Global” Benefit and an Individual or Group Benefit	Individual or Group Benefit
<ul style="list-style-type: none"> • Police • Park Maintenance • Fire Suppression 	<ul style="list-style-type: none"> • Parks and Recreation • Fire Prevention 	<ul style="list-style-type: none"> • Building Permits • Planning and Zoning Approval • Site Plan Review • Engineering Development Review • Facility Rentals

Services in the “global benefit” section tend to be funded primarily through voter-approved tax revenues. In the middle of the table, one typically finds a mixture of taxes,

user fees, and other funding sources. Finally, in the “individual or group benefit” section of the table, lie the services provided by local government that are typically funded almost entirely by user fee revenue. The following are two central concepts regarding the establishment of user fees:

- *Fees should be assessed according to the degree of individual or private benefit gained from services.* For example, the processing and approval of a land use or building permit will generally result in monetary gain to the applicant, as opposed to the community at large.
- *A profit-making objective should not be included in the assessment of user fees.* California laws require that charges for service should generally not exceed the costs associated with providing those services. Once a charge for service is assessed at a level higher than the actual cost of providing a service, the term “user fee” no longer applies. The charge then becomes a tax subject to voter approval.

Therefore, it is commonly accepted that user fees are established at a level that will recover up to, and not more than, the cost of providing a particular service. The fee study provides the analysis to validate the City’s current fees and cost recovery rate, ensuring the fee does not result in a tax.

Discussion

The City sets fees for services considering how those fees could or do recover the full cost of those services. Recreation fees are generally market-based in order to be competitive with public and private entities that offer competing services. While user fees are generally updated each year, comprehensive user fee studies and CAP are conducted in approximate seven-year cycles, with the last study and plan performed in 2016 by Matrix Consulting Group. The CAP is a document that defines the indirect costs of an organization and equitably and fairly distributes them to the beneficiaries of that service. The results of that analysis help determine the indirect costs that are used to calculate the full cost of providing fee-related services. For example, in order to issue a building permit, a building inspector has the direct cost and time to conduct the inspections, but in order for that inspector to do their inspections, they had to be hired by HR, and payroll needed to be processed by Finance, etc. That level of indirect support is captured through the CAP.

Between studies, common practice is to adjust fees by the change in the Consumer Price Index (CPI) or to leave them unchanged. Council approves changes to the City’s Fees and Charges. The last revision of the City’s Fees and Service Charges schedule occurred in July 2023 with the understanding that the fee study and CAP were planned for completion in the current year.

Matrix analyzed the cost of service relationships that exist between internal service divisions (e.g. City Council, City Manager, City Attorney, and Administrative Services)

and fees for service activities related to building permits, planning applications, public works, general services, and parks and recreation. The analysis includes a review of actual revenue, budgeted expenditures, staff time estimates, costs of materials, and overhead. The results of the CAP and User Fee Study provide the City with 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 following is a discussion of the study methodology, study results, and potential areas where changes might occur.

Methodology

Matrix first developed a cost allocation plan (CAP) to account for the full cost of providing specific services to the community by determining indirect (overhead) costs associated with operations. Using time estimates and data, the Matrix analytical model spreads costs from central service departments to those divisions, programs, and/or funds that receive services in support of conducting their operations (see Attachment A). The model is based on many of the methods of indirect cost allocation defined by the federal Office of Management and Budget’s (OMB) Circular A-87 and Generally Accepted Accounting Principles (GAAP).

The methodology employed by the Matrix Consulting Group 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 Division. 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 following table provides an overview of the types of costs included in establishing the “full” cost of services.

Cost Component	Description
Direct	Fiscal Year 2024 Budgeted salaries, benefits, and allowable expenditures.
Indirect	Division, departmental, and Citywide support.

Current Cost Recovery

When comparing FY24 fee-related budgeted expenditures with fee-related revenue the City is under-recovering its costs by approximately \$767,000 or recovering 88% of its costs associated with services that provide direct benefits to individuals or groups. The following table outlines this by major service area, including the revenue collected, the total annual cost, the resulting difference, and the resulting cost recovery percentage.

Service Area	Current Revenue	Total Cost	Difference	Cost Recovery %
Planning	\$716,696	\$886,158	(\$169,462)	81%

Service Area	Current		Difference	Cost
	Revenue	Total Cost		Recovery %
Public Works	\$1,122,328	\$1,182,734	(\$60,407)	95%
Building	\$3,800,581	\$4,337,761	(\$537,180)	88%
Total	\$5,639,605	\$6,406,653	(\$767,048)	88%

Building at roughly \$537,000 is the primary contributor to the overall deficit. Potential modifications to the current fee schedules in this program (expanding various flat fees, reorganizing the Mechanical, Electrical, and Plumbing (MEP) fees section, etc.), as well as adding a fee for Planning Review and Inspection will help to address the cost recovery gap.

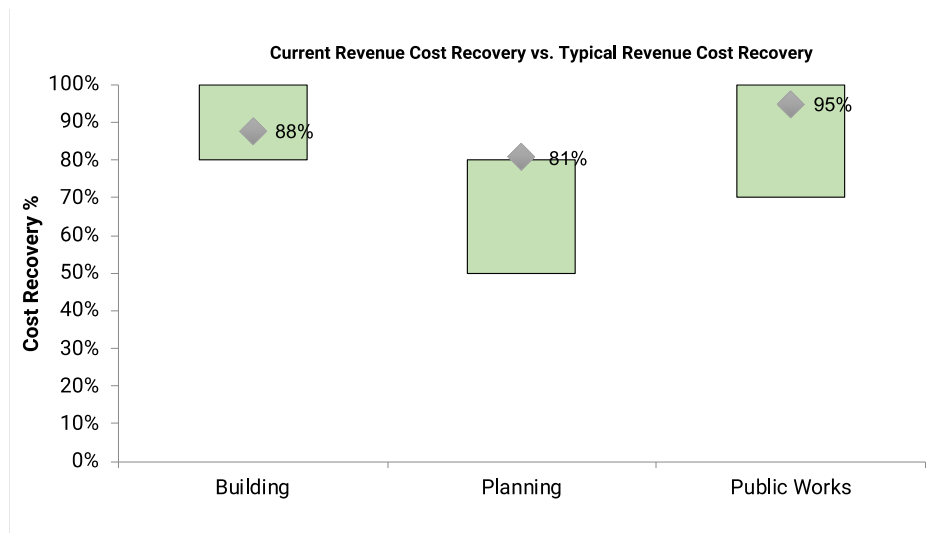
It is important to note that it may not be advantageous to bring all fees to full cost recovery as higher fees may discourage, for example, the application for a permit. Staff will utilize some discretion as the fee schedule is created and proposed for Council.

Market Comparison and Cost Recovery Policy

Cost recovery levels in Cupertino were also compared to levels typically seen in other jurisdictions. The following table reflects the *typical* cost recovery levels observed by local adopting authorities.

Service Areas	Typical Cost Recovery Ranges
Building	80-100%
Planning	50-80%
Public Works	70-100%

Information presented in the table above is based on the Matrix Consulting Group’s experience in analyzing local governments’ operations across the United States and within California and reflects typical cost recovery ranges observed by local adopting authorities. The following graph depicts how Cupertino compares to industry cost recovery range standards.



Public Works and Building fall within the typical cost recovery ranges, while Planning at 81% is just above the typical cost recovery range.

The City will benefit from adopting a formal Cost Recovery Policy, which can be general in nature and can apply broadly to the City as a whole, or to each department and division specifically. A department specific cost recovery policy would allow the City to better control the cost recovery associated with different types of services being provided and the community benefit received. Proposed Cost Recovery Policy components are included later in this staff report.

General Fees

The General Fee category encompasses fees for services which are applied Citywide, such as, photocopies, notary, business licenses, taxi driver permits, block party presentations, etc. Where applicable, fees are proposed to fully recover the cost of service. Exceptions include state regulated fees, penalties, and services with community benefit. Additionally, changes provided in the report include consolidating several fees, eliminating 'Microfilm/Microfiche Printout' (service no longer offered), and the following new fees:

Fee Name	Unit	Total Cost	Difference
Code Enforcement Cost Recovery			
Abatement / Graffiti Cleanup		Actual Cost	
Hourly Rate	Per Hour	\$240	N/A
Substandard Housing Re-Inspection	Per Hour	\$240	N/A
Handbill Permit			
Permit Update	Each	\$120	N/A
Finance - General			
Credit Card Transaction Fees		3.4%	N/A
Emergency Service - General			
Block Party Presentation	Each	\$418	N/A
First Aid / Medical Stand-by at Special Events	Each	\$215	N/A

Public Works Department (Engineering Division)

The Engineering Division is responsible for the daily upkeep and maintenance of City owned and operated facilities and infrastructure. The fees examined within this study relate to oversight and permitting of improvements that affect the public right of way and public infrastructure, including, encroachments, map services, public improvements, tree planting, and other fees associated with tasks performed by the Engineering Division.

Like *General Fees*, fees reflect full cost recovery with the exception of state-regulated fees. Block Parties, with a current cost of approximately \$1,338, have historically been fully subsidized at the direction of City Council. Two fees are proposed for deletion, with the ‘Stormwater Permit -Initial Inspection’ fee rarely used and the ‘Trash Enclosure’ being captured elsewhere. Staff is recommending the following new fees:

Fee Name	Unit	Total Cost	Difference
Encroachment Permits			
Crane Lift	Each	\$1,415	N/A
Review of Public/Private Improvement Plans			
Planning Application Review	Each	\$1,573	N/A
VMT Monitoring Fee	Per Hour	\$188	N/A
Environmental Programs			
Plan Review Fee:			
Single Family	Each	\$157	N/A
Multi-Family	Each	\$313	N/A
Construction and Demolition Diversion Compliance Review	Each	\$106	N/A
Development Project Review	Each	\$271	N/A

Community Development Department (Planning Division)

The Planning division is responsible for ensuring current and future development aligns with the City’s General Plan, Zoning Plan, and specific plans. As such, the fees examined within this study relate to zoning, subdivisions, exceptions, appeals, etc.

Planning under recovers a majority of its fees, with the largest variance category being Appeals; fees ‘Appeals – Planning Commission’ and ‘Appeals – City Council’ are below full cost recovery by \$18,627 and \$18,915, respectively. It is common to see large subsidies in relation to appeals due to the understanding that the benefit to the community having access to the appeal process outweighs the benefit of recovering the full cost to the City.

The following new proposed fees will help recover costs for services currently being provided but for which there is no fee on the fee schedule.

Fee Name	Unit	Total Cost	Difference
Appeals			
Project Review Meeting	Each	\$5,106	N/A
Preliminary Application Review			
Single Family	Each	\$4,042	N/A
Non-Residential (Retail / Industrial / Office / Hotel):			
<10,000 sf	Each	\$9,421	N/A
>10,000 sf	Each	\$12,999	N/A
Residential / Mixed Use:			
Duplex	Each	\$3,428	N/A
3-6 Units	Each	\$14,776	N/A
6-50 Units	Each	\$18,427	N/A
>50 Units	Each	\$23,213	N/A
Planning Inspection	Each	\$860	N/A
Application Revision (after 2nd review)	Each	\$10,400	N/A
		Actual Cost + 15% Admin Charge	
Mercury News Ad			
Special Events	Each	\$7,779	N/A

Community Development Department (Building Division)

The Building Division is committed to safeguarding life, health, property and public welfare through the administration and enforcement of the uniform building codes and adopted City ordinances and policies. Specifically, the Building division provides the following services:

- Plan review and permit issuance of all proposed construction to assure compliance with all state and local building codes.
- Explaining codes, ordinances, requirements and regulations that apply to individual building projects.
- Assisting the public with their concerns about public safety within their homes or places of business.
- Providing building inspection services for all privately funded development.

The fees included for examination in this study relate to plan review and inspection of buildings and structures.

All Building Fees are presented at full cost recovery based on CAP and Fee Study results. Staff worked with Matrix to alter time estimates for all building fees to better reflect current Building Division processes and requirements. Through this process, numerous fees were identified as services no longer offered by the City, and will be removed from future fee schedules. Additionally, staff is proposing the addition of fees for services provided but not captured in the current fee schedule, such as Additions, Thermal

Systems, and Appliances. A comprehensive list is provided in section six, "Building," in Attachment B.

Parks and Recreation—Cost Recovery and Fees

The Parks and Recreation Department strives to enhance the leisure lifestyle and quality of life of both residents of and visitors to the City by providing affordable, fun, integrated, and safe recreational activities for people of all ages and abilities. The Department organizes, markets, and oversees recreation and leisure services in a variety of programs, including a Sports Center, Senior Programs, Youth and Teen activities and classes, trips, facility rentals, and other recreation activities.

Currently, the Department sets and updates class fees internally on a seasonal basis. Membership and facility fees are studied on an annual basis. The primary methodology used for fee-setting is to determine the demand of a program based upon participation, conducting market inquiries, and determining the benefit of the program to the community. These are typically the most important components of determining parks and recreation fees. Changes recommended in the Recreation fee schedule are historically driven by demand and market comparisons of similar services as residents have a choice between utilizing programs offered in their own city or those of a neighboring city. Grants, special funding, or General Fund subsidies often offset programs and services provided by recreation departments in order to ensure that all citizens have equal opportunity and choice of participation.

Recreation fees were not assessed in the User Fee Study. As such, Matrix determined cost recovery levels at the department level only. The typical cost recovery for Parks and Recreation services is between 20-50%. The low-cost recovery for these services is due to the belief that these services primarily benefit the community at large and, as such, are providing a direct benefit to residents and the community, leading to a substantial General Fund subsidy.

Program	Revenue	Direct & Indirect Exp	Difference	Cost Recovery %
Cultural Events	\$1,221	\$768,430	(\$767,209)	0.16%
Facilities	\$203,173	\$802,246	(\$599,073)	25%
Youth Teen Recreation	\$854,411	\$2,827,397	(\$1,972,986)	30%
Senior Center	\$70,129	\$1,437,067	(\$1,366,938)	5%
Youth and Teen Programs	\$0	\$503,414	(\$503,414)	0%
Neighborhood Events	\$0	\$179,317	(\$179,317)	0%
Park Facilities	\$195,207	\$2,536,875	(\$2,341,668)	8%
BBF Golf Course	\$602,779	\$1,217,291	(\$614,512)	50%
Sports Center Operations	\$2,796,329	\$5,116,163	(\$2,319,834)	55%
Outdoor Recreation	\$439,717	\$1,880,645	(\$1,440,928)	23%
Total	\$5,162,966	\$17,268,845	(\$12,105,879)	30%

At \$2.3 million each, Park Facilities and Sports Center Operations are the largest contributors to the Department’s deficit. Since both programs have fees which are primarily based on market-rate, it is imperative that staff and management evaluate these fees and adjust appropriately to not only align with established cost recovery polices and targets but also to lessen the cost recovery gap.

Staff has committed to evaluating business practices with respect to these facilities to maximize the return within the competitive market. The cost recovery study provides the opportunity for the Council to identify specific programs in which there is an interest to explore alternative service delivery models.

Cost Recovery Policy Components

The Government Finance Officers Association’s (GFOA) best practices for Establishing Government Charges and Fees states that governmental entities should adopt formal policies regarding charges and fees which include the jurisdiction’s intention to recover the full cost or partial costs of providing services, sets forth circumstances under which the jurisdiction might set a charge or fee at less than or more than 100% of full cost, and outlines the considerations that might influence the jurisdiction’s pricing decision.

The City is currently developing a cost recovery policy addressing the following three primary components:

- Comprehensive fee study and CAP – Staff is recommending maintaining the current seven-year cycle.
- *Cost recovery target ranges* – Staff is recommending the following ranges:

<u>Service Area</u>	<u>Cost Recovery Range</u>
General	100%
Building	80-100%
Public Works	75-100%
Planning	50-80%
Recreation	Market-driven

- *Annual fee update/Increase mechanism* – Continuing the City’s current process, user fees (Schedules A-D) will be updated by CPI or to state-regulated limits.
- *Phase-in period* – fees with greater differences between current and full cost recovery rates will gradually increase over multiple years to reach full cost recovery.
- *Parks and Recreation Fees exclusion* – fees will be administratively updated per Resolutions No. 04-350, authorizing the City Manager to set all recreation fees.

Next Steps

City Staff will return to City Council in April with the Fiscal Year 2024-25 Proposed Fee Schedules (A-D) and Cost Recovery Policy for adoption.

Sustainability Impact

No sustainability impact.

Fiscal Impact

There is no direct fiscal impact from this agenda item. Adjustments that derive from the fee study may lead to increased revenue up to \$767,048 that could provide direct General Fund relief to the structural budget deficit.

California Environmental Quality Act

Not applicable.

Prepared by: Jonathan Orozco, Finance Manager

Reviewed by: Kristina Alfaro, Director of Administrative Services

Approved for Submission by: Matt Morley, Assistant City Manager

Attachments:

A - Cost Allocation Plan

B - User Fee Study Final Report