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MEMORANDUM

To: Kurt Triplett, City Manager

From: Tracey Dunlap, Director of Finance and Administration
 Kyle Butler, Budget Analyst

Date: August 21, 2014

Subject: **DEVELOPMENT FEE UPDATE – COST OF SERVICE PRELIMINARY RESULTS**

RECOMMENDATION:

City Council review the preliminary cost of service results of the development fee update and provide further direction to staff.

BACKGROUND DISCUSSION:

This memo summarizes the preliminary cost of service results and recommendations from the most recent development fee update. The update evaluates both the current cost of service as well as the degree to which the fee structure is recovering costs at the target levels established by the City Council. In addition, this update addressed fee-related recommendations from the Development Services Organization Review completed by Zucker Systems in March 2013, including consideration of adjusting fees to full cost recovery over time.

A brief history of the City’s past development fee studies was provided at the August 6, 2014 Council meeting. To briefly recap, the full cost of providing development services includes direct costs, department indirect costs and citywide overhead costs. The following chart shows the various “layers” of costs considered.

FULL COST OF DEVELOPMENT SERVICES	
City-Wide Overhead	↑ Calculated share of the cost of the internal functions of City government
Departmental Overhead	Calculated or estimated share of the cost of departmental management & administration
Indirect Functions	Hours & associated expenses spent on indirect support activities (Code Enforcement, Public Information, Policy Development, etc.)
Direct Development Services Work	Hours & associated expenses spent on permits & other development activities

Target recovery levels (expressed as percentages) were established by Council, most recently in 2007. The cost recovery targets reflect the amount of costs that should be recovered from fees and is based on the perceived public benefit versus private benefit that accrues from development services. To the extent that the service

benefits an individual, costs should be borne by the individual (i.e., fee-supported). To the extent that the service provides an overall benefit to the general community, the costs should be borne by everyone (i.e., tax-supported). It is important to note the distinction between "department" costs and "activity" costs. Building permit activities include costs from all three of the departments involved in development services. Likewise, planning permit processes involve not only Planning Department staff, but also involve staff time from the Public Works Department and the Fire and Building Department. Each department has its own cost recovery target by cost layer based on the Council's policy guidance on public versus private benefit. The following is a brief summary of the rationale for the cost recovery targets by cost layer:

Cost Layer	Building Services	Fire Prevention	Planning	Public Works
<p>Direct Development Service These costs represent the direct, hands-on work performed to provide development services. Both Planning & Public Works consider part of their regulatory responsibilities benefit the public by protecting existing City environment, character, and infrastructure; whereas, Building and Fire solely benefit the private projects they regulate.</p>	100%	100%	80%	80%
<p>Code Enforcement These costs are associated with ensuring compliance with City code. The cost recovery is based on not penalizing compliant development projects for those who do not follow City regulations. A portion of these costs might be recovered through fines or penalties.</p>	0%	0%	0%	0%
<p>Public Information Cost recovery based on department judgment of the amount of front-counter time that is attributable to the level of development active in the City.</p>	50%	50%	20%	50%
<p>Policy Development This level of recovery was determined because much of the City's planning and policy development focuses on maintaining a specific community "look and feel" for the public. In addition, much of the planning aspects the City performs are required regardless of the level of ongoing development.</p>	20%	20%	20%	20%
<p>General Administration, Training, Department & City-Wide Overhead The labor costs and expenses associated with these activities are targeted to recover in proportion to the recovery levels in the other cost layers based on a weighted average of each department's cost recovery. It is assumed the level of work is proportional to that under all others.</p>	weighted average of all other cost layers			

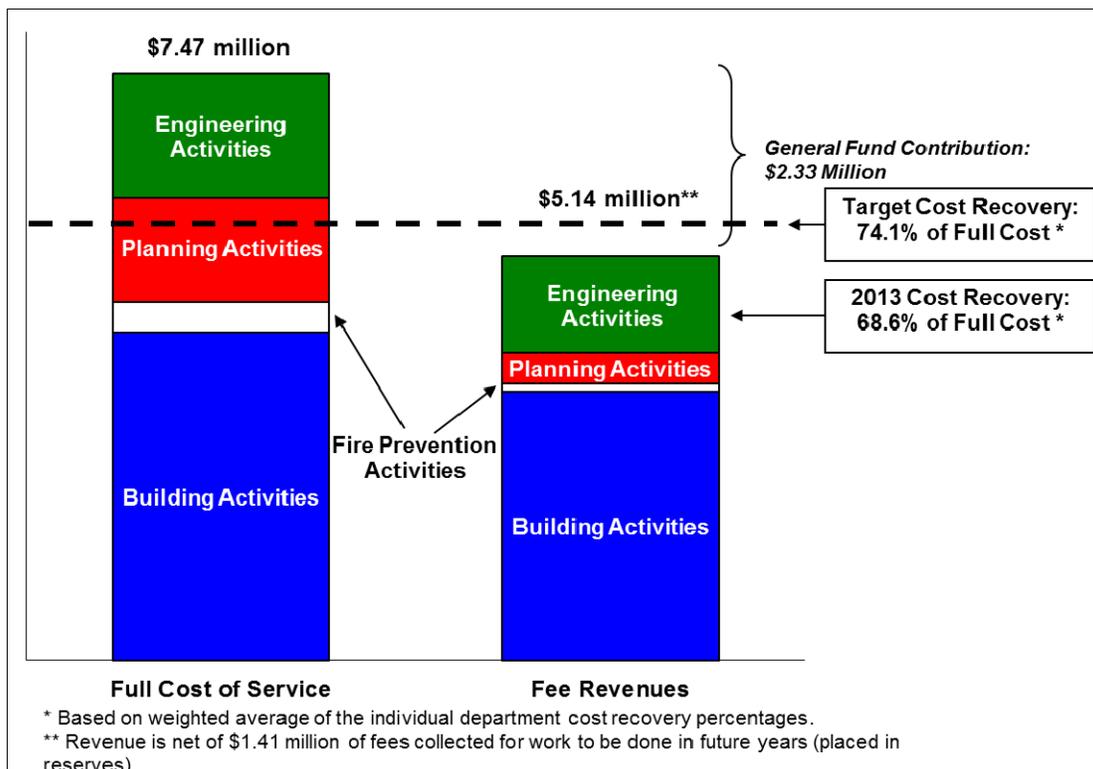
Preliminary Results

The cost recovery targets by cost layer were applied to each department based on the time spent in each activity in 2013, resulting in the following cost recovery targets.

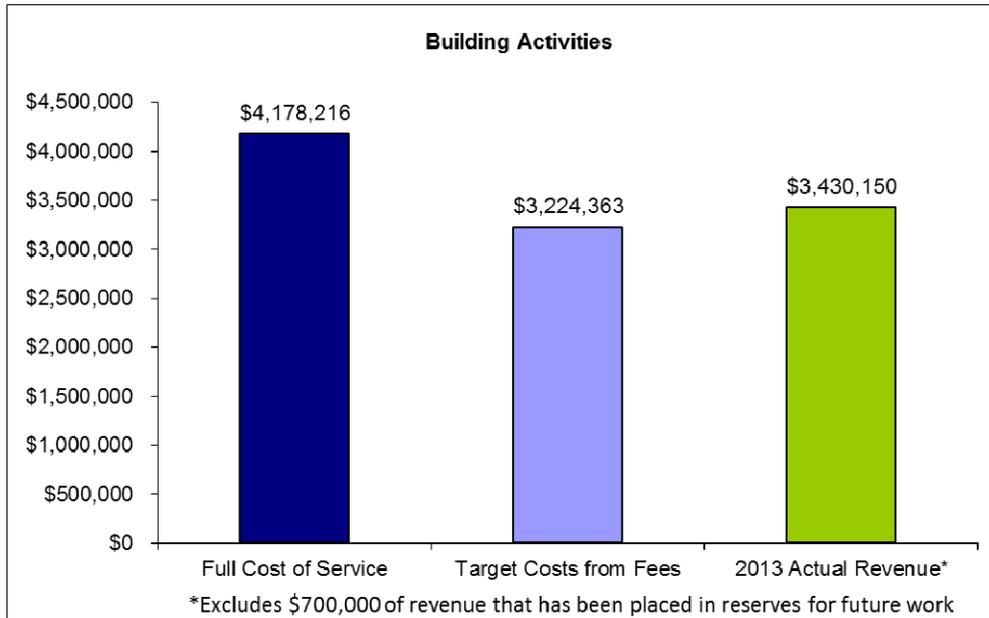
Service Cost Layer	Building Services	Fire Prevention	Planning*	Engineering	Overall
Direct Services	100%	100%	80%	80%	90%
Code Enforcement	0%	0%	0%	0%	0%
Public Information	50%	50%	20%	50%	36%
Policy Development	20%	20%	20%	20%	20%
Department & City Overhead	as others	as others	as others	as others	as others
2013 Updated Target Recovery	83%	84%	55%	77%	74%

* Costs exclude long-range planning activities.

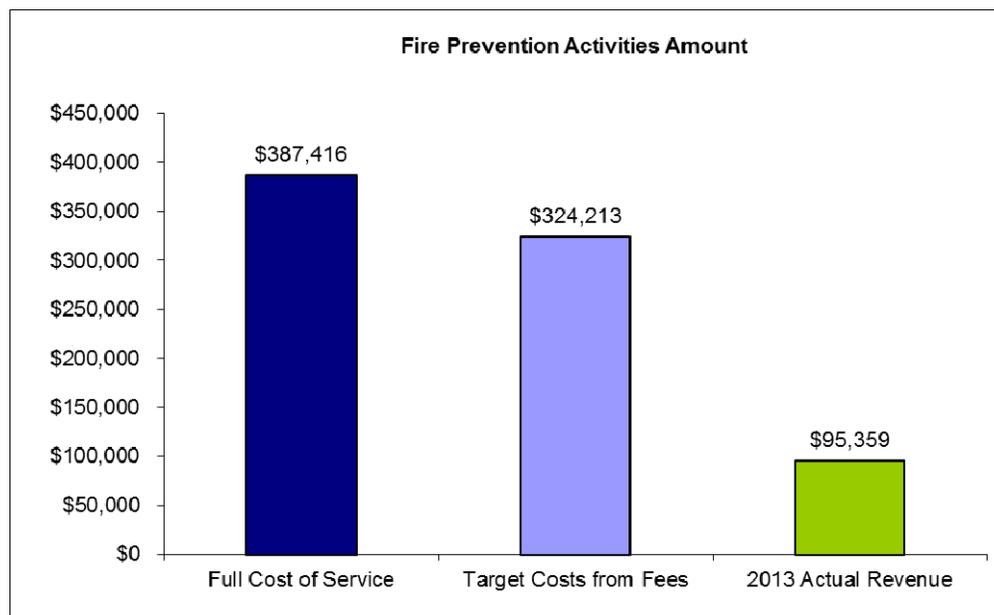
The 2013 cost of service update applies the same methodology used in previous updates whereby current costs were determined, the current targets applied and a comparison against actual revenue made. The full cost of development services in 2013 was \$7.47 million, of which \$5.14 million was recovered from fees. Overall, estimated fees for development activities recovered 69% of full cost, which is about \$430,000 short of the target recovery in 2013 of 74%. This means that 69% of the total cost of providing these services is paid from fees, with the remaining \$2.33 million not covered by fees paid by General Fund tax revenues. It is important to recognize that this evaluation looks at a snapshot in time (calendar year 2013), while the development process can span years. The fee revenue shown is net of revenues set aside to pay for work that will occur in future years. Evaluating the target recovery is not a precise exercise, rather it is intended as an indicator that fees are reasonably in-line with Council policy. The chart below compares the full cost of development services actual revenues in 2013.



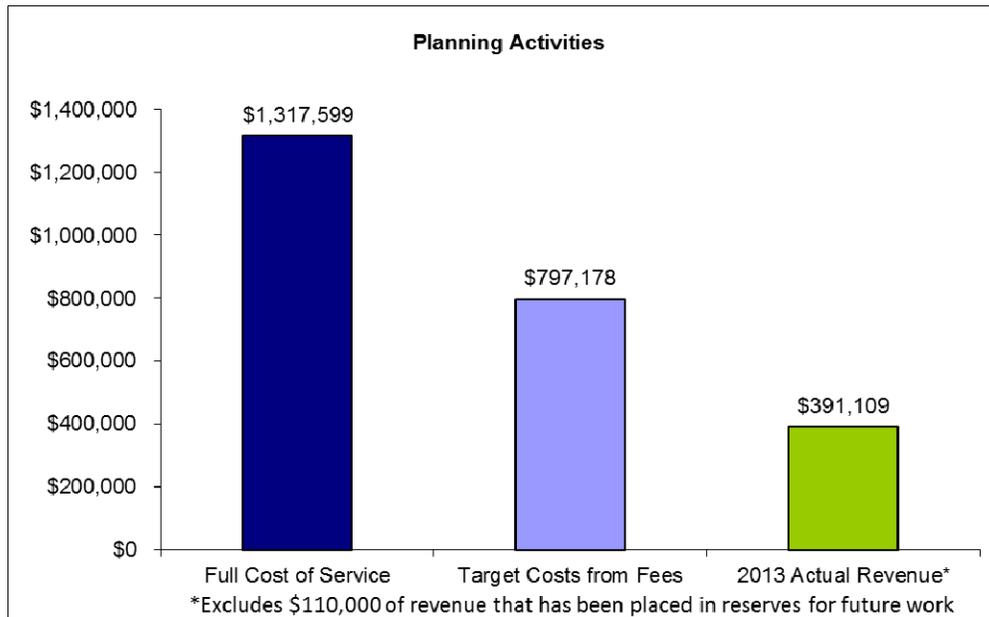
To place the overall results in context, the cost recovery of each category of activities was analyzed. **Building services are slightly over their target cost recovery.** While the building services are slightly over-recovering compared to target (106%), they are in fact still recovering substantially less than the total cost of providing these services. Furthermore, the study looks at a point in time in regards to cost and revenue. The building workload related to specific permits may extend over a long period of time and revenues that are received in one year are needed to pay for ongoing services that cross into the following year (e.g. inspections). The chart below compares the full cost, target costs, and the 2013 revenues of building services activities (net of reserves for future work).



Fire Prevention activities are below their target recovery. The fees for fire prevention-related development activities is generating 29% of the target costs to be recovered. In the past, the Fire Prevention Division has raised the issue that the City's fees are substantially lower than those in surrounding jurisdictions. In order to reach the target recovery level, fire prevention fees would need to increase 240%. Further information on fee comparisons and recommendations will be presented at the next City Council meeting. The chart below compares the full cost, target costs, and the 2013 revenues of fire prevention activities.



The Planning development activities are recovering 49% of the target level recovery. For these Planning activities to recover the target cost of 55% an overall fee increase of 104 percent would be required. The chart below compares the full cost, target costs, and the 2013 revenues of planning development activities.



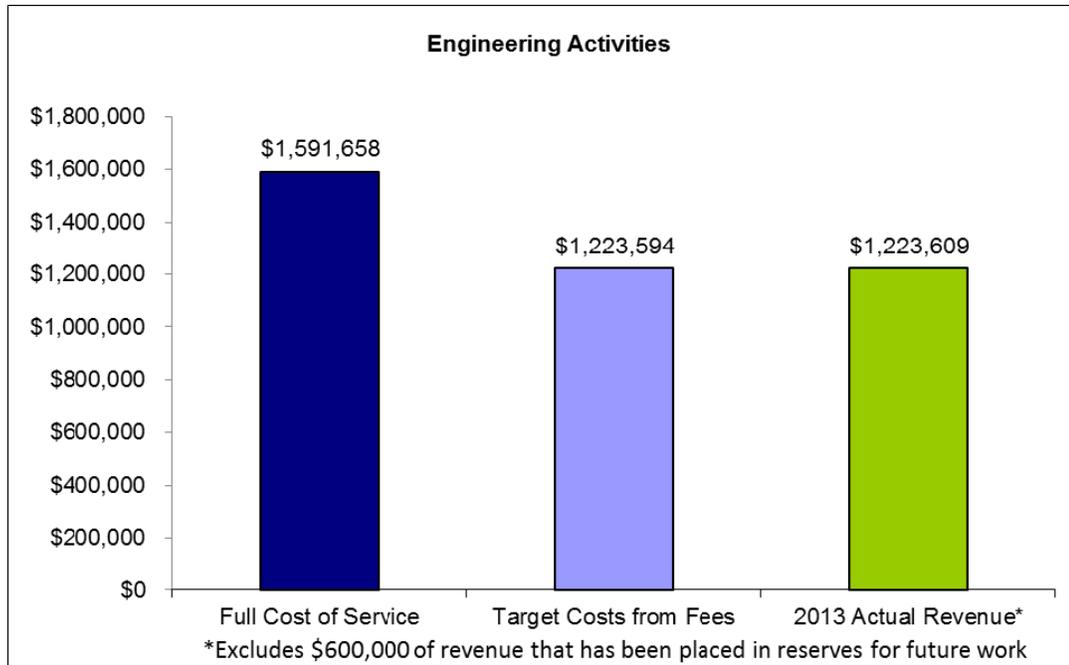
This result is in line with the findings of prior reviews and is primarily driven by three factors:

- The costs of pre-submittal meetings far exceeds the revenues generated by the \$500 fee, as shown in the table below. Previous City Council's made the explicit decision to subsidize these fees. The cost recovery on planning activities is at 66% of target recovery if pre-submittal meetings are excluded.

Pre Submittal Meetings	Building	Fire Prevention	Planning	Public Works	Total
Full Cost	\$23,146	\$67,293	\$256,880	\$145,533	\$492,852
Current Target Recovery	83%	84%	55%	77%	74%
Target Cost	\$19,174	\$56,315	\$141,406	\$111,533	\$328,426
Current Revenue					\$82,356
Actual Recovery					17%

- The Process I review fee is significantly lower than the costs involved in doing the plan review and Kirkland's fees are lower than neighboring cities, recovering only 35% of the cost. Specific data and recommendations for increasing this fee will be brought forward at the next meeting.
- Environmental Review (SEPA) fees are only recovering 8% of the cost of providing the service. Specific data and recommendations for increasing this fee will be brought forward at the next meeting.

Public Works engineering fees are recovering the target cost. It should be noted that engineering services functions are much like building permit activities in that revenue received in one year is needed for ongoing services in the following year. In addition, the fees are based on the valuation of the improvements and are therefore subject to significant fluctuations. The chart below compares the full cost, target costs, and the 2013 revenues of public works engineering activities (excluding revenues set aside in reserves for work in future years).



Analysis and Recommendations

The table below summarizes the increases in fee revenues necessary to meet target recovery objectives and to reach full cost recovery.

	2013 Full Cost	2013 Target Cost	2013 Revenue	Increase Needed for Target Cost Recovery	Increase Needed for Full Cost Recovery
Building Activities	\$4,178,216	\$3,224,363	\$3,430,150	n/a	22%
Fire Prevention Activities	\$387,416	\$324,213	\$95,359	240%	306%
Planning Activities	\$1,317,599	\$797,178	\$391,109	104%	237%
Public Works Activities	\$1,591,658	\$1,223,594	\$1,223,609	n/a	30%
Total	\$7,474,888	\$5,569,348	\$5,140,226	8%	45%

-Additional Revenue at full cost = \$2.33 million

The statutory guidance that applies in setting fees is as follows:

RCW 82.02.020 provides: *"Nothing in this section prohibits cities, towns, counties, or other municipal corporations from collecting reasonable fees from an applicant for permit or other governmental approval to cover the cost to the city, town, county or other municipal corporation of processing applications, inspecting and reviewing plans, or preparing detailed statements..."* (emphasis added).

The key terms in this language are "reasonable fees" and "cost". The reasonableness of fees is often evaluated based on whether they have a rationale nexus to the service provided and in looking at comparisons with other jurisdictions. Cost has been viewed in the context of full cost as discussed earlier.

Some of the considerations in deciding whether to move toward full cost recovery include:

- At full cost recovery, the development community bears the full cost of services with no General Fund contribution. This can be both a positive and a negative. The General Fund contribution currently used to subsidize development services could be allocated to other purposes or some of the General Fund could be used to enhance service levels (which, by definition, then continues some level of subsidy).
- Full cost fees will increase the cost of development and could be perceived as negatively impacting economic development.
- Full cost fees might not compare favorably with other jurisdictions due to different cost recovery objectives, regulatory structures, and community values.

Comparative data with other jurisdictions will be provided as part of the next presentation on this topic. Staff is likely to recommend the following based on preliminary information:

- Rather than adjusting the cost recovery targets, focus on moving fire prevention and planning activities closer to the current target by increasing fire prevention fees, the Process I planning fee and potentially other under-recovering activities.
- Defer consideration of phasing in full cost recovery to a future fee update.
- Process housekeeping adjustments to other selected fees to recognize current practices or modify applicant behavior.
- Increase the current MBP.com surcharge to cover costs and fund other market-driven technology improvements.

If Council is comfortable with maintaining the current cost recovery targets, the Finance and Administration Committee is expected to review the recommended fees at their September 4 meeting and fees will be brought forward for consideration by the full Council on September 16 or October 7. If changes to the cost recovery approach are directed, staff will need to update the analysis and fees would be brought forward for consideration at a later date.