



November 15, 2022

**SUBJECT: FY23-24 COST RECOVERY ANALYSIS RESULTS**

The San Diego Air Pollution Control District (SDAPCD or District) retained the Matrix Consulting Group to conduct an update to its Cost Recovery Study. The following memo provides a background of the project scope, the legal framework within which the cost recovery study was conducted, modifications to the current cost recovery model, the overall results, and the recommended cost recovery scenario.

## **1 Project Background and History**

The California Health and Safety Code Sections 41512 and 42311 allow the District to recover the full costs associated with renewal, evaluation, and issuance of permits. These sections also provide limits on fee increases for permit to operate and authority to construct permits, restricting aggregate revenue increases to 15% annually. Based upon this legal authority, the District has a goal to review its fees every year to ensure that all fee-related costs are captured, and maximum cost recovery achieved.

In 2020, the State Auditor issued a report regarding SDAPCD, which identified that fee-related expenses were not being fully recovered. As a result of these findings, the SDAPCD conducted its first external fee evaluation in 2021, with study results presented and adopted by the SDAPCD Governing Board in May 2021. Prior to the implementation of fee increases in 2021 the District had not raised fees in three years.

At the end of 2021, the Matrix Consulting Group worked with the District to conduct an update to the study conducted earlier in 2021. This update incorporated staffing and budgetary adjustments as well as several fee program modifications. The results of this analysis were presented and adopted by the Board for implementation July 1, 2022. In September 2022, the Matrix Consulting Group began working with the District to conduct the next update to the Cost Recovery Analysis for implementation on July 1, 2023.

The goal of this study was to update the analysis from last year based upon new inputs associated with staffing, costs, workload, and any changes in fee structures.

## 2 Legal Framework

The California Health and Safety Code and Proposition 26 are the two primary legal frameworks governing the fees and revenue requirements for the Air Pollution Control Districts. Proposition 26 considers all charges imposed by a local government as a tax, except for the following seven exceptions:

- 1. Fees and Charges for Specific Benefit Conferred or Privilege Granted:** This is in relation to a payor receiving a service that is only provided to that payor specifically, and the costs for this must not exceed the reasonable costs of providing that service.
- 2. Fees and Charges for Specific Government Service or Product Provided:** This is similar to the first exception and is directly in relation to a service or tangible product received, and it must not exceed the reasonable cost of that service or product. This is the exception that is used for “user fees”.
- 3. Regulatory Fees and Charges:** This is in relation to issuing licenses and permits, performing investigations, inspections, audits, and administrative enforcement of regulated activities. These charges must be based on reasonable regulatory costs.
- 4. Use of Government Property:** This is in relation to using park or government facilities, so purchase, rental or lease of any government owned property.
- 5. Fines and Penalties:** This is in relation to any charges that are imposed as a result of violation of local or state regulations.
- 6. Fees and Charges Imposed as Condition of Development:** This is in relation to impact fees and requires a nexus of how the development has a specific correlation to the impact.
- 7. Property Related Fees and Charges and Assessments:** This is in relation to utility / service fees that are imposed in relation to the property such as water, sewer, trash, etc.

The Air District’s fees fall under the exception #3 primarily with a handful of fees that are under exception #2. The language of Proposition 26, states that the local government must ensure that the fees imposed for any of these exceptions should be based upon the reasonable costs necessary to cover those activities or provide those services. Additionally, there should be a reasonable relationship that exists between the cost and the benefit borne by the payors of these fees.

The Cost Recovery Model (provided under separate cover to the District) calculates the full cost of conducting regulatory activity and providing any fees for service. These costs

include the direct (hands on staff conducting inspections for compliance and reviewing applications), as well as indirect support associated with those activities (i.e., permit processing, rule development, human resources, finance, IT, etc.). The District also ensures that it follows all state and federal guidelines in relation to conducting any compliance inspections or application reviews to ensure that the fee payor is only paying for their fair share of services received. Unnecessary application reviews and inspections are not imposed upon the facility. Any fines and violations for lack of compliance would be imposed separately outside of the fee process.

This study calculates the full cost (direct and indirect) associated with each fee line item assessed by the District. Therefore, for each individual fixed fee, renewal fee, asbestos, or hearing board item, it is ensured that the total fee proposed or recommended does not exceed the full cost of providing the service.

For example, in Rule 40, for Schedule 2A there is a current fixed application fee of \$4,797. Through the FY23-24 Cost recovery study, the full cost calculated for this fee is \$6,032. The District is proposing to increase all fees by 15%, resulting in the recommended fee being \$5,516. The proposed fee of \$5,516 does not exceed the full cost of \$6,032. Conversely, Schedule 13W shows a fixed application current fee of \$802 and full cost of \$840. As a 15% fee increase would result in the recommended fee being \$922 the District is recommending this fee to be set at full cost (\$840) or a 5% increase.

Therefore, as the examples demonstrate, even though the District applies a recommended fee percentage increase across the board to a fee schedule, each individual fee is evaluated to ensure that it does not exceed the maximum justifiable full cost fee calculated through the cost recovery model.

### 3 Modifications to Current Cost Recovery Model

All cost recovery studies are a snapshot in time. The FY22-23 study focused on FY21-22 adopted budget and staffing, as well as FY20-21 completed workload information. Due to the nature of fee studies, the cost assumptions utilized to develop the fees are typically backward looking and based upon the current adopted budget for future fee increases. The concept being that future costs should generally be reflective of current costs. For the FY23-24 Cost Recovery Model, the project team incorporated the following data and assumptions:

- FY22-23 Adopted Budget For District Programs
- FY22-23 Adopted Staffing Levels with updates to staffing costs.
- FY21-22 Completed Workload Information

- July 2022 Adopted Fee Amounts
- Conversion of fees from Fixed Fees to Time and Material (T&M) to represent the variation in level of effort more accurately.

These model inputs ensured that the FY23-24 model was updated consistent with the current cost recovery model methodology. It also ensures that future fee increases are based upon the most recent cost and organizational structure of the District.

## 4 Cost Recovery Results

When comparing FY 22-23 fee-related expenditures with fee-related revenue based upon FY21-22 workload, the District is providing a subsidy of approximately \$2.4 million, recovering approximately 80% of annual fee-related costs. The following table outlines these results based upon major fee category assessed by the District:

**Table 1: Annual Cost Recovery Analysis**

| Fee Category        | Revenue at Current Fee | Total Annual Cost   | Annual Surplus / (Deficit) | Cost Recovery % |
|---------------------|------------------------|---------------------|----------------------------|-----------------|
| Initial Application | \$776,715              | \$976,674           | (\$199,959)                | 80%             |
| Renewal Fees        | \$5,314,017            | \$6,230,153         | (\$916,136)                | 85%             |
| Source Testing      | \$772,823              | \$1,540,551         | (\$767,728)                | 50%             |
| Asbestos Fees       | \$1,139,334            | \$1,159,175         | (\$19,841)                 | 98%             |
| Hearing Board Fees  | \$9,139                | \$44,507            | (\$35,368)                 | 21%             |
| Time & Material     | \$1,395,040            | \$1,795,498         | (\$400,458)                | 78%             |
| Processing Fee      | \$518,086              | \$589,398           | (\$71,312)                 | 88%             |
| <b>TOTAL</b>        | <b>\$9,925,156</b>     | <b>\$12,335,956</b> | <b>(\$2,410,800)</b>       | <b>80%</b>      |

The largest source of the District's current deficit relates to Renewal fees. Renewal Fees represent 38% of the District's current deficit, with the next largest impact associated with Source Testing Fees. Currently, this deficit is primarily being recovered through Vehicle Registration fee surcharges, rather than through permit holders.

## 5 Cost Recovery Recommendation

Last year the Board adopted a fee increase scenario that was targeted on increasing all fees that are subject to the 15% aggregate fee rule. The California Health and Safety Code Section 41512.7(d)(2) states that the District has the ability to increase individual fees for service for permit to operate and authority to construct permits as long as the total revenue for those fee categories does not exceed more than 15% in a single fiscal year.

The District has traditionally followed this Health and Safety Code guideline by applying it to Application Fees, Renewal Fees, Time and Material, and Processing Fee categories

as those fees fall under the “permit to operate” and “authority to construct” permit category. For all other fee categories – Source Testing, Asbestos, and Hearing Board the District is not bound to any limits on fee or revenue increases other than the requirement that the fee cannot exceed the cost of providing the service. Therefore, under this recommended fee increase, the District is able to apply different cost increases to the fee categories to allow for greater cost recovery for the District.

The Board adopted proposed percentage increases from last year are recommended to also be applied to this year, with two key exceptions:

1. **Asbestos:** For the last two years the Board has adopted a 25% increase in Asbestos Fees. Due to that strategy, this year, the Board only needs to increase Asbestos fees by 15% in order to achieve full cost recovery. Therefore, for this category it is recommended that fees are only increased by 15%.
2. **Hearing Board:** Hearing Board fees comprise 0.09% of the revenue for the District and as such only 0.36% of its costs. Increasing these fees consistently at the 25% rate may result in the Hearing Board fees becoming cost prohibitive, without having a significant revenue impact upon the District. Therefore, it is being recommended that these fees see a 0% increase.

The following table summarizes by major fee category, the current cost recovery percentage, whether it is subject to the Aggregate Fee increase of 15%, the projected fee increase percentage for FY23-24, and the resulting FY23-24 Cost Recovery percentage:

**Table 2: Proposed Cost Recovery Impacts of Recommended Fee Increases**

| Fee Category      | Current Cost Recovery % | Subject to Aggregate Cap of 15%? | FY23-24 Fee Inc. % | FY23-24 Cost Recovery % |
|-------------------|-------------------------|----------------------------------|--------------------|-------------------------|
| Application Fixed | 80%                     | Yes                              | 15%                | 91%                     |
| Renewal           | 85%                     | Yes                              | 15%                | 94%                     |
| Source Testing    | 50%                     | No                               | 15%                | 58%                     |
| Asbestos          | 98%                     | No                               | 15%                | 100%                    |
| Hearing Board     | 21%                     | No                               | 0%                 | 21%                     |
| T&M               | 78%                     | Yes                              | 15%                | 87%                     |
| Processing Fee    | 88%                     | Yes                              | 15%                | 89%                     |

The District’s current cost recovery for its fees ranges from a low of 21% for Hearing Board to a high of 98% for Asbestos fees. The highlighted rows in the table above represent those categories that are subject to the 15% revenue limit, meaning the total revenue for those fees combined cannot exceed 15%. As the table indicates, fee categories that are subject to the cap of 15% revenue increase, the fee increases are all set at 15%. For all other fee categories, the fee increase is the same as the last fiscal year and Board adopted increase. The following table shows for each of the major fee

categories, the current revenue, the projected revenue at the targeted increase, and the resulting revenue increase:

**Table 3: Proposed Revenue Increase Impacts**

| Fee Category        | Revenue at Current Fee | Total Projected Revenue | \$ Difference    |
|---------------------|------------------------|-------------------------|------------------|
| Initial Application | \$776,715              | \$893,140               | \$116,425        |
| Renewal Fees        | \$5,314,017            | \$5,838,855             | \$524,837        |
| Source Testing      | \$772,823              | \$888,747               | \$115,923        |
| Asbestos Fees       | \$1,139,334            | \$1,158,714             | \$19,379         |
| Hearing Board Fees  | \$9,139                | \$9,139                 | \$0              |
| Time & Material     | \$1,395,040            | \$1,561,515             | \$166,475        |
| Processing Fee      | \$518,086              | \$524,644               | \$6,558          |
| <b>TOTAL</b>        | <b>\$9,925,156</b>     | <b>\$10,874,754</b>     | <b>\$949,599</b> |

The District’s total revenue would increase by an estimated \$950,000 from \$9.93 million to \$10.87 million. The largest increase in revenue would be renewal fees estimated at \$525,000, followed by Time & Material fees estimated at \$166,000. The estimated \$950,000 would represent a 10% increase in revenue for the District and **would result in the District’s cost recovery increasing from 80% to 88%.**

As the District gets closer to cost recovery there will be less of a need for significant annual fee increases, as once cost recovery is achieved, annual fee increases will only need to match typical annual cost increases (i.e., 3-5%).

The following table summarizes the advantages and disadvantages of the proposed fee increases from the perspective of internal (District) and external (permit and fee holders) stakeholders:

**Table 4: Cost Recovery Recommendation – Advantages and Disadvantages**

| Advantages  | Disadvantages  |
|---|--|
| <ul style="list-style-type: none"> <li>• <b>Internal:</b> Increased revenue for the District.</li> <li>• <b>External:</b> Lower fee increases for Asbestos and no fee increases for Hearing Board.</li> </ul> | <ul style="list-style-type: none"> <li>• <b>External:</b> Continued fee increase for rate payors.</li> </ul> |

The proposed fee increases are consistent with previously adopted Board practices, enables the District to continue its movement towards increasing cost recovery, and applies fee increases based upon estimated level of cost recovery.