

**FY22-23 Cost Recovery Analysis and
Recommendations**

**SAN DIEGO AIR POLLUTION CONTROL DISTRICT
(SDAPCD), CALIFORNIA**

FINAL REPORT

February 2022

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1 Introduction and Executive Summary

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 report provides the results of this analysis.

1 Background

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, as well as increase fees by more than 15% as long as aggregate revenue does not exceed 15% for permit to operate and authority to construct permits. 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.

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.

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

2 Summary of Cost Recovery Results

When comparing FY 21-22 fee-related expenditures with fee-related revenue based upon FY20-21 workload, the District is providing a subsidy of approximately \$3.4 million, recovering approximately 72% 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	\$489,851	\$679,265	(\$189,415)	72%
Renewal Fees	\$4,991,361	\$6,778,724	(\$1,787,363)	74%
Source Testing	\$672,034	\$1,287,551	(\$615,517)	52%
Asbestos Fees	\$809,850	\$1,092,468	(\$282,618)	74%
Hearing Board Fees	\$9,975	\$54,889	(\$44,914)	18%
Time & Material	\$1,430,599	\$1,909,269	(\$478,670)	75%
Processing Fee	\$424,035	\$465,417	(\$41,382)	91%
TOTAL	\$8,827,705	\$12,267,584	(\$3,439,879)	72%

The largest source of the District's current deficit is Renewal fees. Renewal Fees represent 52% 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.

The District's current deficit of \$3.4 million is a reduction from its previous deficit of \$4.0 million. However, in order to continue the District's increased cost recovery, the project team worked with District staff to develop the recommended fee increase option. The following table shows by major fee category the proposed fee increase under the recommended fee increases and the resulting cost recovery.

Table 2: Proposed Cost Recovery Impacts of Recommended Fee Increase

Fee Category	FY22-23 Fee Inc. %	FY22-23 Cost Recovery %
Application Fixed	15%	83%
Renewal	15%	84%
Source Testing	15%	60%
Asbestos	25%	92%
Hearing Board	25%	23%
T&M	15%	86%
Processing Fee	15%	98%

The recommendation allows the District to focus on increasing revenues across all fee categories consistent with the previous year's increase and generate additional revenue to continue to increase its cost recovery. Under the recommended fee increase, the District would be projected to increase its estimated revenue by \$1.3 million and overall estimated cost recovery from 72% to 83% and decrease its projected deficit from \$3.4 million to \$2.1 million.

2 Updates to Cost Recovery Model

The Matrix Consulting Group conducted an update to the Cost Recovery model created in 2021 for use in FY22-23 for the District. As part of this cost recovery update, there were several key modifications and changes from last year's model. The following subsections discuss all changes made to the Cost Recovery Model for FY22-23.

1 Cost Inputs

All cost recovery studies are a snapshot in time. The 2021 study focused on FY20-21 adopted budget and staffing, as well as FY19-20 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 FY22-23 Cost Recovery Model, the project team made the following key changes and updates:

- FY21-22 Adopted Budget For District Programs
- FY21-22 Adopted Staffing Levels with updates to reflect any mid-year staffing shifts between programs.
- FY20-21 Completed Workload Information
- January 2022 adopted fee amounts

These model input changes ensured that the FY22-23 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.

2 Environmental Justice Program Support

The District's Office of Environmental Justice was established by the Air pollution Control Board in September of 2020 to support and expand the District's environmental justice work in the region. However, as the District's environmental justice activities continue to grow, there needs to be additional financial resources dedicated to supporting this program. The following table compares the District's current Environmental Justice Program staffing and cost components to the proposed components that have been factored into the Cost Recovery Model.

Table 3: Environmental Justice Components

Current	Proposed
1 Deputy Director	1 Deputy Director 1 Program Coordinator – supporting Office of Environmental Justice Outreach costs of \$50,000 for translations, publications, mailings, videos, etc.

The proposed Environmental Justice Components represent an additional \$212,000 annually, accounting for the addition of a Program Coordinator, as well as increased outreach costs. Environmental Justice Program costs have been included as overhead, meaning that the cost has been spread over both fee and non-fee activities. As such, only a portion of these costs are being passed onto fee related activities and permits. The nexus for that support is that regional and localized air pollution from stationary sources contributes to air quality challenges in communities disproportionately burdened by poor air quality. Conversely, those stationary sources also benefit from the District’s focus on Environmental Justice and Outreach, which helps our region coordinate efforts on reducing air pollution from multiple sources and improve air quality in a more comprehensive way.

3 Blended Hourly Rates for Time & Material

Currently, SDAPCD publishes staff hourly rates as part of its Fee Regulation (Schedule 94). These hourly rates are broken out by distinct classification and used across the different fee schedules for “T&M” (Time and Material) fees. Depending upon the application or project, multiple positions can bill, and different hourly rates can be assessed.

Through this study, the project team worked with District staff to streamline this process and establish greater transparency as it relates to T&M fees. The result of this was the creation of division / program specific blended hourly rates. These hourly rates would be for services rendered by each division or program and would be a singular rate. The following table shows by category the full cost blended rate.

Table 4: Blended Hourly Rate Category Calculation

New Service Categories:	Full Cost Hourly Rate
Engineering Services	\$279
Monitoring Services	\$162
Source Testing Services	\$244
Compliance Services	\$260
Planning / Mobile Incentives Services	\$171

The full cost blended rates were developed based upon the salaries, benefits, productive hours, programmatic, and district-wide overhead. Additionally, rather than taking a straight average across all positions, the project team blended the rate based upon the ratio of staff within each classification. For example, This weighted average then ensures that if there are more Associate Engineers compared to Senior Engineers, the Engineering rate is more heavily weighted towards the Associate Engineers. These blended rates are a better reflection of the District's current operating practices. The following points discuss the key advantages to this new approach:

1. **Simplified Rate Structure:** Rather than listing all position classifications (authorized and / or filled) the rate structure is more based upon the services being received.
2. **Transparency in T&M Fees:** Currently, if an applicant has a T&M fee, there is no way to know which level of classification will be assigned and it is difficult to budget. This type of structure will allow applicants to have a better understanding of if the T&M is for Engineering, then the Engineering rate would apply.
3. **Consistency in Fees:** Currently, a similar permit or application can pay a different amount in fees depending on which position classification is assigned to the application (i.e. Senior vs. Associate). Under the proposed blended rate structure, regardless of the level of assignment a singular rate would be applied to ensure that permits and applications requiring similar services pay similar fees.

Implementing this new approach will allow the District to better capture the range of different services it provides in a more consistent manner.

4 After Hours On Call Program

AB 423 amended State law with a requirement to evaluate the District's air quality complaint program and propose recommendations for improvements to the program, including a 24-hour hotline. The District is in the process of implementing a 24-hour hotline through an after-hours on call complaint program. This would require District compliance staff to be available to respond to after hour complaints during hours outside regular business hours (Monday thru Friday, from 8:00 am – 5:00 pm). SDAPCD is currently in the process of developing this program fully. However, for purposes of the next budget year, the District anticipates this program to be funded through additional overtime expenses. The estimated costs associated with this program are estimated to be \$200,000 and were incorporated into the cost recovery model.

5 Conversion of Fixed Fees to Time & Material (T&M)

The final change that was made in this cost recovery model was converting fees under the Application category from Fixed Fees to Time and Material fees. While it is typically considered more beneficial to convert from Time and Material to fixed fees, there can be reasons why Time and Material fees are appropriate. The most common reason for Time and Material is that there is too much variation in the level of effort and coming up with a singular average would be too unfair for all applicants. The District converted many of their fees to Time and Material for two major reasons:

1. **Lack of Workload Data:** Some of the fixed fee applications hadn't been processed in the last 5-10 years, and as such there was no substantial time tracking information to rely upon when developing reasonable averages. It was determined that due to their rarity, it is better to change them based on Time and Material, so that those applications are charged their fair share of workload and effort.
2. **Significant Variation in Time:** When evaluating time tracking data, some fixed fees had too much of a variance and as such it was determined that there is no reasonable average that can be estimated for these items and a Time and Material category is more appropriate.

Currently, under Rule 40, there are approximately 58 fixed fees for Applications and 148 fixed fees for Renewals. Of those 58 fixed application fees, approximately 27 (47%) are being converted to Time and Material fees. For the majority of those fee categories there has been no workload, so it does not have an impact on the applicants making this conversion. It also ensures that the District charges those applications the actual staff time and effort spent reviewing those applications and modifications.

3 Cost Recovery Recommendation

The Matrix Consulting Group analyzed the cost of service relationships that exist between the District and its customers in relation to Initial Application Fees, Renewal Fees, Source Testing, Asbestos, Hearing Board, and Time and Material fees.

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 the 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. The following table summarizes by major fee category for the District, the current cost recovery percentage, whether it is subject to the Aggregate Fee increase of 15%, the projected fee increase for FY22-23 and the resulting FY22-23 Cost Recovery %:

Table 5: Proposed Cost Recovery Impacts of Recommended Fee Increases

Fee Category	Current Cost Recovery %	Subject to Aggregate Cap of 15%?	FY22-23 Fee Inc. %	FY22-23 Cost Recovery %
Application Fixed	72%	Yes	15%	83%
Renewal	74%	Yes	15%	84%
Source Testing	52%	No	15%	60%
Asbestos	74%	No	25%	92%
Hearing Board	18%	No	25%	23%
T&M	75%	Yes	15%	86%
Processing Fee	91%	Yes	15%	98%

The District’s current cost recovery for its fees ranges from a low of 18% for Hearing Board to a high of 91% for Processing 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 6: Revenue increase Impacts – Scenario 1

Fee Category	Revenue at Current Fee	Total Projected Revenue	\$ Difference
Initial Application	\$489,851	\$563,328	\$73,478
Renewal Fees	\$4,991,361	\$5,699,138	\$707,777
Source Testing	\$672,034	\$772,839	\$100,805
Asbestos Fees	\$809,850	\$1,000,352	\$190,502
Hearing Board Fees	\$9,975	\$12,469	\$2,494
Time & Material	\$1,430,599	\$1,642,141	\$211,543
Processing Fee	\$424,035	\$455,681	\$31,645
TOTAL	\$8,827,705	\$10,145,949	\$1,318,244

The District’s total revenue would increase by an estimated \$1.3 million from \$8.8 million to \$10.1 million. The largest increase in revenue would be renewal fees estimated at \$708,000, followed by Time & Material fees estimated at \$212,000. The estimated \$1.3 million would represent a 15% increase in revenue for the District and would result in the District’s cost recovery increasing from 72% to 83%. The following table summarizes the advantages and disadvantages of this scenario from the perspective of internal (District) and external (permit and fee holders) stakeholders:

Table 7: Scenario 1 – Advantages and Disadvantages

Advantages	Disadvantages
<ul style="list-style-type: none"> • Internal: Consistent with previous increase. • Internal: Increased revenue for the District. • External: Fee increases are consistent across all categories. 	<ul style="list-style-type: none"> • External: Significant fee increases within a 6 month timeframe. Some payors will be affected with a 30% increase.

The key advantages to this recommendation is that it is consistent with previous Board adopted practice, enables the District to continue its movement towards increasing cost recovery, and applies fee increases consistently across the categories.

4 Future Cost Recovery Considerations

All cost recovery studies are a snapshot in time. Therefore, they only capture the picture based upon a fixed set of variables. These variables, such as staffing levels, cost needs, level of effort, and other items are constantly shifting and evolving based upon real life situations. As part of this study, the project team recommends that as the District looks to future cost recovery models, it keep in mind the following key items:

- **Increased Costs:** The District has newly separated from the County and is transitioning away from County financial systems as well as reliance on County support. This will lead to increased internal support costs associated with new financial systems, new support staff, and other increased overhead support. These factors are important to keep in mind, as this will affect future cost recovery calculations.
- **Cost Recovery Target / Policy:** A formalized policy should be developed and adopted by the Board, which identifies the District's cost recovery goals (i.e., 85%, 90%, or 100% of its fee-related costs). This will ensure that as the District calculates fee recovery annually, it can determine where and how to set fees to meet the Board directive.
- **Annual Fee Increases:** Similar to cost recovery policy, an annual fee increase policy should be adopted. If there is no formalized fee increase from a cost recovery study, the Board should adopt a policy to increase fees based upon the District's Cost of Living Adjustment (COLA). This will ensure that in the absence of a more a substantial fee increase, fees at least maintain the prior year's cost recovery level.

These future considerations will be important to review and ensure are incorporated in future analyses as the District works its way towards achieving greater cost recovery annually.