

Profiting from Building Permit Fees **March 20, 2001**

Summary

In response to a complaint from a Marin County resident, the Grand Jury investigated whether excessive building permit fees are being charged by Marin jurisdictions.

The California Constitution specifies that: "The general rule is that a regulatory fee must not exceed the sum reasonably necessary to cover the costs of the regulatory purpose sought in order to be considered as a fee rather than a guise for a tax." A 1993 California Attorney General's Opinion (No. 92-506) also addressed this issue and concluded that building permit fees cannot exceed the estimated reasonable cost of providing building inspection services, unless approved by a two-third vote of the electorate.

Building permit fees typically are based on the construction cost of a project. The higher the construction expenditures, the higher the permit fee, no matter the cost of providing the permit services. Based upon information provided to the Grand Jury by local jurisdictions, many of them appear to be profiting by collecting excessive building permit fees in violation of the Attorney General's Opinion.

For fiscal year 1999/2000, the total building permit fee profits (revenues in excess of costs), based on data reported to the Grand Jury by Marin cities and the County was almost \$1.3 million. Several cities in Marin reported collecting particularly large amounts of excess fees during that year: Novato, about \$400,000; Belvedere, about \$300,000; San Rafael, about \$225,000; Mill Valley, about \$210,000; and Ross, about \$150,000.

Looking at cumulative profits and losses for each jurisdiction over the past three fiscal years (1997/1998, 1998/1999 and 1999/2000), several of the cities again reported making large profits from building permit fees: Novato, about \$1.3 million; San Rafael, about \$700,000; Mill Valley, about \$500,000; Ross, about \$325,000; and Belvedere, about \$320,000. The total cumulative profit reported by Marin jurisdictions for the three-year period was almost \$3.7 million.

On the basis of information supplied to it, the Grand Jury discovered that the records that some Marin jurisdictions keep are inadequate to confirm whether they are, or are not, complying with the applicable Attorney General's Opinion. It appears that they may be assigning general overhead and costs of other activities, which are not specifically related to building inspection functions, to building permit expenses.

Background

The Building Inspection Division of the Marin County Community Development Agency provides building inspection services in the unincorporated area of the county. Each of the 11 cities in Marin provides its own building inspection services for properties located within its city limits.

Cities in Marin typically calculate their building permit fees based on 100% of the Uniform Building Code Valuation Tables developed by the State of California. The tables were designed to reflect average construction costs across the state. Because construction costs in Marin are generally far above the state average, the resulting permit fees here are generally higher than in other areas of California.

The clearest legal description regarding appropriate building permit fees can be found in a March 9, 1993, California Attorney General's Opinion (No. 92-506), which concluded:

1. A local agency is prohibited from charging building permit and similar fees which exceed the estimated reasonable costs of providing the services rendered unless the amounts of the fees are approved by the electorate.
2. A local agency may not charge building permit and similar fees based upon the Uniform Building Code Valuation Tables which are in excess of the estimated reasonable costs of providing the services rendered unless the amounts of the fees are approved by the electorate.
3. If a local agency charges building permit and similar fees based upon the Uniform Building Code Valuation Tables without supporting evidence regarding the relationship between the fees and the

services rendered, such fees are invalid to the extent they exceed the reasonable costs of providing the services rendered.

Building permit fees are not a large portion of the total cost of construction and are easily passed on to a homeowner or ultimate purchaser who usually has little -- if any -- specific knowledge of the fees, how they are determined or their reasonableness. Architects and contractors who may appreciate the relationship between permit costs and the services provided have little incentive to complain because they have on-going work with building inspection department personnel and depend upon them to approve plans and inspections of work. Besides, their clients are often unaware of, or at least don't complain about, the costs.

During the investigation, an individual formerly involved in building construction in Marin described the practice of overcharging for building permits as "one of those dirty little secrets that everyone (in the construction industry) knows about, but is afraid to complain about".

Methodology

The Grand Jury first contacted the State Attorney General's Office to determine what legal restrictions apply to building inspection charges. The Jury was provided a copy of Attorney General's Opinion No. 92-506, which is attached as Appendix A. Members of the Grand Jury then collected data from and/or talked with personnel from a representative sample of small, medium and large cities in the County.

After it became clear to the Grand Jury that violations of the Attorney General's Opinion probably were occurring, the County and all 11 cities in Marin were sent letters requesting that they provide the Grand Jury with the total building inspection function revenues and expenses for the past three fiscal years (1997/1998, 1998/1999 and 1999/2000). All jurisdictions complied with the request from the Grand Jury and responded to follow-up questions seeking clarification of the information submitted.

There are clearly differences in the way the County and the cities account for their building inspection expenses. While some of the expense information received from cities seemed questionable (in that indirect and overhead costs may be overstated), the Grand Jury decided to utilize the information submitted by the jurisdictions after some follow-up clarification. To do otherwise would have required extensive analysis, auditing of operations and considerably more time involving building and/or finance department staff. The data reported by the jurisdictions and presented here seemed adequate to justify a conclusion that excess revenues are being generated from building permit fees.

Discussion

Homes and commercial buildings that use higher-end building materials (as is typically the case in Marin) obviously cost more to build. As a result, their building permits also cost more since permit fees are typically based upon the cost of the construction. At the same time, the actual cost of plan checking and construction inspection varies little between a 2,500 sq. ft. home costing \$300,000 and a 2,500 sq. ft. home costing \$3,000,000; or one with Formica countertops and vinyl flooring and one with Corian countertops and marble floors.

While salaries and other direct and indirect costs are also high in Marin, they have not kept pace with the increase in construction costs. As a result, building permit fees collected often exceed (sometimes vastly exceed) the actual cost of providing building inspection services and large profits have been generated for some Marin jurisdictions. For fiscal year 1999/2000, the total excess building permit fee revenue reported to the Grand Jury by cities in Marin and the County itself was almost \$1.3 million. Several of those cities collected particularly large amounts of excess fees during that year.

Because the level of building activity varies from year to year and some construction projects take more than one year to complete, the Grand Jury also looked at cumulative profits and losses reported by each jurisdiction over the past three fiscal years (1997/1998, 1998/1999 and 1999/200). The Grand Jury again found that several of the cities reported collecting particularly large amounts of excess fees during that three-year time period. Based upon the information submitted to the Grand Jury, the total cumulative profit made in Marin County over the three-year period, from excess building permit fees, was almost \$3.7 million.

To put the excess fees in perspective, the Grand Jury looked at the profits (revenues which exceed expenses) as a percentage of the building permit fees charged. The cities with the largest profits reported for fiscal year 1999/2000 were: Mill Valley, 64%; Ross, 46%; Belvedere, 45%; San Rafael, 37%; Fairfax, 26%; San Anselmo, 22%; and Novato, 20%. Based upon the information reported to the Grand Jury by the cities, many of them clearly appear to be profiting by collecting excess building permit fees in violation of California Attorney General's Opinion No. 92-506.

With the exception of the County, which has established a "trust account" into which excess building permit revenues are deposited to be carried over for "lean years", the profits from building permit fees typically are deposited in the jurisdiction's general fund and used to fund other general municipal services. Cities should consider establishing trust accounts similar to the County's in order to allow them to carry over excess building permit revenues to subsequent fiscal years for expenditure on building inspection related activities.

According to the County Auditor-Controller, the balance in the County Building Inspection Division Trust Account on February 23, 2001, was \$314,613. While concern was expressed to the Grand Jury about the balance the County maintains in the Trust Account, the Grand Jury found that the balance had been reduced 58% from the \$741,401 balance, which was in the account on June 30, 1999.

It was reported to the Grand Jury that the building inspection related expenses of Marin jurisdictions have increased recently because of an increased level of construction activity. Additionally, the jurisdictions stated that the increases were due to their need to provide additional services, such as being open to the public for longer hours and because of increased staffing.

The Grand Jury found that published public agency budgets often do not break down the specific costs of construction inspections, plan checks, administration, supervision or overhead allocations. The Jury also found widely disparate costs of service or overhead — as is obvious from the large differences in the relationship between reported building inspection expenses and size (population) of the jurisdiction. It appeared that some cities might have overstated overhead costs to the Grand Jury in order to reduce profits from, or show a loss in, providing building inspection services. Under California law, the larger the expense reported, the higher the fees that can legally be justified. This system obviously does not reward efficiency since there is little incentive to reduce operating or overhead expenses.

Because of a challenge of County permit fees by the construction industry several years ago, the County of Marin has been charging only a percentage of the Uniform Building Code Valuation Tables and has adjusted this percentage periodically. Until recently, the County Building Inspection Division was charging 60% of the Uniform Building Code fee schedule. As of February 16, 2001, the County Building Inspection Division increased building permit fees by 33% (to 80% of the Uniform Building Code fee schedule) to reportedly fund additional services.

Based upon what the Grand Jury found, it appears that many of the cities should consider using a similar practice in order to comply with Attorney General's Opinion No. 92-506. Other than for the County, the Grand Jury was able to find little supporting documentation to justify the fees currently being charged. In addition, no jurisdiction has attempted to obtain voter approval to charge building permit fees that exceed the cost of providing the service as specified in the Attorney General's Opinion.

Findings

- For fiscal year 1999/2000, the Grand Jury found - as indicated in the following chart - that the total excess building permit fee revenue reported by cities in Marin and the County was \$1,285,174. Several cities in the County reported collecting particularly large amounts of excess fees during that year: Novato, \$397,979; Belvedere, \$295,602; San Rafael, \$224,697; Mill Valley, \$211,434; and Ross, \$151,316. The Grand Jury also looked at the reported cumulative profit or loss over the past three fiscal years (1997-2000) and again found that several of the cities reported collecting particularly large amounts of excess fees: Novato, \$1,352,463; San Rafael, \$700,334; Mill Valley, \$500,909; Ross, \$324,024; and Belvedere, \$318,222. The total cumulative profit reported by Marin jurisdictions over the three-year period was \$3,693,663. Based upon the information reported to the Grand Jury by the County and the cities, the Jury found that many of them are, in fact, profiting by collecting excessive building permit fees in violation of California Attorney General's Opinion No. 92-506. Reported profits that exceed \$100,000 are highlighted in the following chart.

Reported Building Permit Fee Profits or (Losses)

	1999/2000	1998/1999	1998/1997	3 Year Total
Belvedere Profit (Loss)	295,602	48,264	(25,644)	318,222
Corte Madera (Loss)	(6,149)	(15,968)	(8,589)	(30,706)
Fairfax Profit	48,028	41,853	36,219	126,100
Larkspur (Loss)	(66,916)	(41,163)	(68,426)	(176,505)
Mill Valley Profit	211,434	154,103	135,372	500,909
Novato Profit	397,979	788,722	165,762	1,352,463
Ross Profit	151,316	129,261	43,447	324,024
San Anselmo Profit	85,188	40,766	1,817	127,771
San Rafael Profit	224,697	281,343	194,294	700,334
Sausalito (Loss)	(81,160)	(102,301)	(117,156)	(300,617)
Tiburon Profit	71,146	35,888	85,898	192,932
County of Marin Profit (Loss)	60,821	2,536	(12,449)	50,908

- The Grand Jury found that many jurisdictions apparently do not keep sufficiently detailed information on assignment of expenses to be able to determine the precise level of compliance with the Attorney General's requirement to keep fees in line with the cost of providing building inspection services.
- Based upon a jurisdiction-by-jurisdiction comparison of reported building inspection expenses and the population of the jurisdiction, the Grand Jury had questions regarding the accuracy of the expense information provided to it by several jurisdictions. While efficiency (or lack thereof) could certainly account for some of what seemed to be the relatively high reported expenses indicated below for some jurisdictions, lack of detailed information on the assignment of indirect costs and overhead made it difficult for the Grand Jury to determine whether the jurisdictions actually comply with the Attorney General's requirement to keep fees in line with the cost of providing building permit services.

Reported Total Revenues & Expenses

(Population figures are CA Department of Finance estimates as of January 1, 2000)

1999/2000	1998/1999	1998/1997
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Belvedere
(population 2,318)

Revenue	662,378	346,160	284,951
Expenses	366,776	297,896	310,595
Profit (Loss)	295,602	48,264	25,644
Over/(Under) Charge	45%	14%	(9%)

**Corte
Madera**(population
9,104)

Revenue	257,654	234,328	320,222
Expenses	263,794	250,296	328,811
(Loss)	(6,149)	(15,968)	(8,589)
(Under) Charge	(2%)	(7%)	(3%)

Fairfax
(population 7,188)

Revenue	183,237	157,699	142,332
Expenses	135,209	115,846	106,333
Profit	48,028	41,853	36,219
Over/(Under) Charge	26%	36%	25%

Larkspur
(population 11,950)

Revenue	168,554	190,850	133,638
Expenses	235,470	232,013	202,064
(Loss)	(66,916)	(41,163)	(68,426)
(Under) Charge	(40%)	(22%)	(51%)

Mill Valley
(population 14,114)

Revenue	333,031	313,000	224,483
Expenses	121,597	158,897	89,111
Profit	211,434	154,103	135,372
Over Charge	64%	49%	60%

Novato
(population 48,952)

Revenue	1,993,184	2,262,396	1,324,604
Expenses	1,595,205	1,473,674	1,158,842
Profit	397,979	788,722	165,762
Over Charge	20%	35%	13%

Ross
(population 2,312)

Revenue	329,852	293,596	226,192
Expenses	178,536	164,335	182,745
Profit	151,316	129,261	43,447
Over Charge	46%	44%	19%

San Anselmo
(population 12,470)

Revenue	391,000	335,000	266,000
Expenses	305,812	294,234	264,183
Profit	85,188	40,766	1,817
Over Charge	22%	12%	1%

San Rafael(population 54,752)

Revenue	612,164	735,588	670,946
Expenses	387,467	454,245	476,652
Profit	224,697	281,343	194,294
Over Charge	37%	38%	29%

Sausalito
(population 7,835)

Revenue	276,251	226,001	209,725
Expenses	357,411	328,302	326,881
(Loss)	(81,160)	(102,301)	(117,156)
(Under) Charge	(29%)	(45%)	(56%)

Tiburon
(population 8,892)

Revenue	416,683	336,692	294,494
Expenses	345,537	300,804	208,596
Profit	71,146	35,888	85,898
Over Charge	17%	11%	29%

**Unincorporated
Marin County**
(population 69,784)

Revenue	1,599,065	1,313,614	1,279,462
Expenses	1,538,244	1,311,078	1,291,911
Profit (Loss)	60,821	2,536	(12,449)
Over/(Under) Charge	4%	0%	(1%)

- For fiscal year 1999/2000, the Grand Jury found, as indicated in the preceding chart, large profits (revenues which exceed expenses) expressed as a percentage of the building permit fees charged, reported by: Mill Valley, 64%; Ross, 46%; Belvedere, 45%; San Rafael, 37%; Fairfax, 26%; San Anselmo, 22%; and Novato, 20%. These figures represent the reductions in fees that would have been required during the fiscal year so that building permit revenue equaled the reported cost of providing building inspection services. Reported profits that exceeded 20% of the fees collected in any fiscal year, are highlighted on the chart.

Recommendations

1. The County of Marin and its 11 cities keep accurate and detailed records of the time and direct personnel costs involved in providing building inspection services to make it easier to confirm compliance with Attorney General's Opinion No. 92-506.
2. The County of Marin and its 11 cities keep accurate and detailed records regarding the assignment of indirect costs from other departments and general overhead costs to make it easier to confirm compliance with Attorney General's Opinion No. 92-506.
3. As specified in Attorney General's Opinion No. 92-506, if a city or the County wishes to utilize excess building permit fees as a revenue source, they must seek a two-thirds vote of the electorate to do so.
4. Those cities generating excess revenue from building permit fees should consider applying a percentage to the Uniform Building Code Valuation Tables similar to the approach used by the County Building Inspection Division. This percentage should be adjusted from time to time, as necessary, to comply with the Attorney General's Opinion No. 92-506 and keep building permit fees in line with the actual cost of providing building inspection services. If they are able to justify the expense numbers reported to the Grand Jury, the cities of Larkspur and Sausalito, which indicated large losses in providing building inspection services, should consider raising building permit fees to reduce or eliminate the current general fund subsidy.
5. Those cities that still generate excess revenue from building permit fees, even after implementing the above recommendations, should consider establishing a trust account (similar to the County's) in order to allow the carry over of the excess revenues to subsequent fiscal years for expenditure on legitimate building inspection services and related activities.

Pursuant to CA Penal Code Section 933.05, the Grand Jury requests responses from:

Marin County Board of Supervisors Findings 1-3 and Recommendations 1-3

Belvedere City Council Findings 1-4 and Recommendations 1-5

Corte Madera Town Council Findings 1-3 and Recommendations 1-4

Fairfax Town Council Findings 1-4 and Recommendations 1-5

Larkspur City Council Findings 1-3 and Recommendations 1-5

Mill Valley City Council Findings 1-4 and Recommendations 1-5

Novato City Council Findings 1-4 and Recommendations 1-5

Ross Town Council Findings 1-4 and Recommendations 1-5

San Anselmo Town Council Findings 1-4 and Recommendations 1-5

San Rafael City Council Findings 1-4 and Recommendations 1-5

Sausalito City Council Findings 1-3 and Recommendations 1-4

Tiburon Town Council Findings 1-4 and Recommendations 1-5