



Photo: Greg Linhares, City of Oakland

PERFORMANCE AUDIT OF THE DEVELOPMENT SERVICES FUND: CENTRALIZED FUND MANAGEMENT WILL BETTER CAPTURE CITYWIDE COSTS

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June 28, 2024

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June 28, 2024

RESIDENTS OF OAKLAND
HONORABLE MAYOR
HONORABLE CITY COUNCIL
HONORABLE CITY ATTORNEY
CITY ADMINISTRATOR

**RE: Performance Audit of the Development Services Fund: Centralized Fund Management
Will Better Capture Citywide Costs**

Dear Residents of Oakland, Mayor Thao, City Council President Bas, Members of the City Council, City Attorney Parker, and City Administrator Johnson:

Our Office completed a performance audit of the Development Services Fund (Fund 2415). The audit had a narrow objective to identify reasons for the high year-end balances of the Development Services Fund. The fund balance peaked at \$149 million in Fiscal Year (FY) 2020-21. During the audit, the projected fund balance decreased substantially. The 2023-25 Biennial Budget projected a fund balance of \$37.3 million in FY 2023-24 and \$5 million in FY 2024-25. Though the Budget Bureau noted that this is a conservative projection, and actual cash fund balances are not the same as budgeted cash fund balances, we sought to understand how the City manages the Fund to ensure its structural integrity.

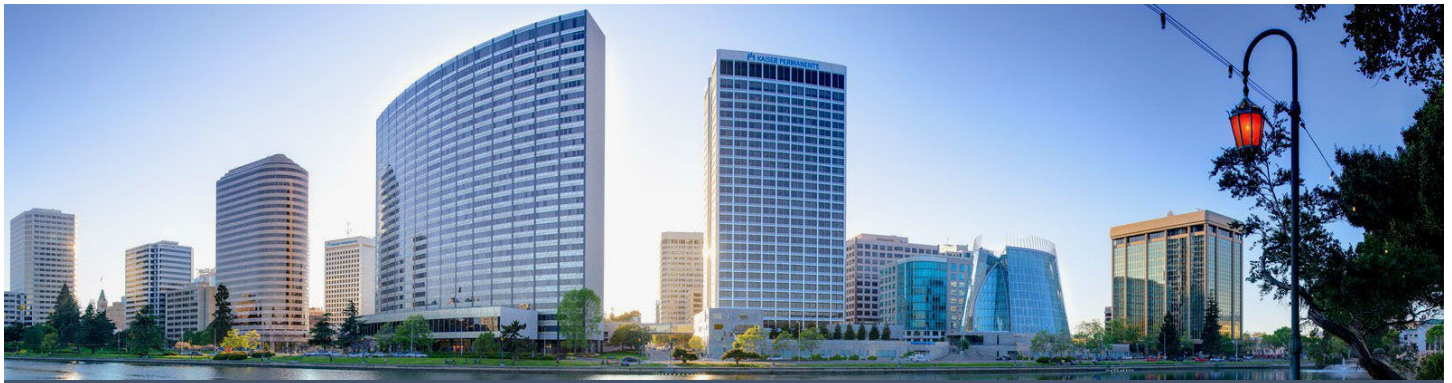
During the audit, the City Administration made progress in undertaking a fee study to identify the costs associated with providing development services, as well as expanding the study to include departments beyond Planning and Building. We made two recommendations to create a policy to have periodic fee studies to cover all departments that contribute to and draw from the Fund, on an ongoing basis, and to establish criteria for what types of staff may be funded with development service fees, as the number of staff funded with these fees has increased over time.

We appreciate the City Administrator's Office, the City Attorney's Office, the Finance Department, and the Planning and Building Department for their cooperation and insight during this audit.

Sincerely,

A handwritten signature in black ink that reads "MCHouston". The signature is written in a cursive, flowing style.

Michael C. Houston, MPP, CIA
City Auditor



REPORT HIGHLIGHTS

Development Services Fund: Centralized Fund Management Will Better Capture Citywide Costs

Background

The City of Oakland regulates new development in the city to ensure compliance with State Building Code, City amendments to the Building Code, and City planning codes. The City permits development projects based on reviews of plans and inspections of the projects. Multiple departments provide these development services. Applicants pay fees to cover costs of the City's development review process and the Development Services Fund holds money that the City collects from these fees. State law requires that the fees cities collect to fund development services cover only the reasonable cost of providing the service. The amount of money in this fund has fluctuated over the last seven fiscal years, peaking at \$149 million in Fiscal Year (FY) 2020-21. The 2023-25 Biennial Budget projected the fund balance to decrease to \$5 million in FY 2024-25, though the Budget Bureau notes this is a conservative projection.

What We Found

We found that over the past seven years, the City had relatively high fund balances in the Development Services Fund. At the same time, revenues and workload have varied while expenditures have increased. We also found the City's development service fees most likely do not tie to the cost of providing service due to the age and limited coverage of fee studies to date. This creates potential for structural issues with the Fund. Fee studies validate the cost recovery of fees. The City has not updated its development fees based on a fee study in nearly ten years, and has not conducted a comprehensive fee study for all departments that use or contribute to the Fund. While the City is working to complete an updated fee study covering development services, it can better ensure development fees cover the cost of services by regularly assessing the costs of providing development services by all departments that contribute to and draw from the Development Services Fund.

What We Recommend

We made two recommendations to ensure future development service fees meet cost recovery goals: create a policy to have periodic development fee studies to cover all departments that contribute to and draw from the Fund, and establish criteria for what types of staff may be funded with development service fees.

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INTRODUCTION & BACKGROUND

Introduction

The Development Services Fund (Fund 2415) holds money that the City of Oakland (City) collects from development service fees that arise from the permitting of development projects throughout the city. State law requires that the fees cities collect to fund development services cover only the reasonable cost of providing the service.¹ The City established the Development Services Fund in 2006 to create a separate program that tracks revenues from development fees separately from the General Purpose Fund (Fund 1010), and to ensure those revenues fund the City's cost of providing appropriate development services in accordance with State law.

The objective of this audit was to review the management of the Development Services Fund, which had a year-end fund balance of \$149 million in Fiscal Year (FY) 2019-20, and is projected to have a fund balance of \$5 million in FY 2024-25, according to the Fiscal Year 2023-25 Biennial Budget.

¹ Cal. Gov. Health and Safety Codes including Safety Code 17951 and Proposition 26

INTRODUCTION & BACKGROUND

Background

The City permits new development in compliance with applicable State and local laws.² The State Building Code and the City's local amendments establish standards for the safety and habitability of structures.

The City permits development projects based on a review of the project. Multiple departments provide these development services. Property owners, contractors, and architects typically apply for permits with the City's Planning and Building Department, Fire Department, Department of Transportation, Economic and Workforce Development Department, the City's Surveyor's Office, or Public Works Department depending on the scope of their development project. The relevant departments then review the project plans for compliance with State law and local planning and building codes and, upon construction, inspect the development for adherence to the approved plans. The departments are also responsible for ongoing monitoring and Code Enforcement response to ensure that development projects adhere to the project's conditions of approval and environmental mitigation measures, if there are any.

The Size and Scope of Development Projects Vary, As Does the Staff Time Required to Review Them

Development projects vary from the City's approval of water heater installations in single-family homes, to complex new construction projects of many thousands of square feet. The time it takes to review and inspect varies considerably based on the project scope and information provided within the developer's submission.³

For scale, in FY 2022-23, the City's Planning and Building Department issued 15,700 building permits and processed approximately 13,700 applications for various building permits.

Development Fees Are Intended to Cover the Reasonable Cost of Providing the Service

Applicants pay fees to cover the reasonable cost of the City's development review and enforcement process. The City's master fee schedule outlines specific development services administered by the City, and their corresponding fees and charges. (See Appendix for a listing of example development service fees.)

² These laws may include State planning and zoning laws, State housing laws, the California Environmental Quality Act ("CEQA"), the City Planning Code (Title 17 of the Oakland Municipal Code), the City's General and Specific Plans, State Building Code, and the City's local amendments to the State Building Code. The state planning and zoning Laws, State housing laws, the City's Planning Code, and its General and Specific Plans set forth the rules and regulations for the processing of development projects that can occur in the City, what entitlements may be granted, and under which timelines they must be granted.

³ For example, projects like high rises and three- to seven-story mixed use apartment and commercial buildings that were completed between 2016 and 2022 took a median time of three years and two months to complete. Residential projects completed in the same years took a median time of two years and three months. It should be noted that timelines are often outside the control of the City. For example, City staff may need to request additional information of the applicants, which can cause delays.

INTRODUCTION & BACKGROUND

State law restricts development service fees to cover only the reasonable cost of providing the service.⁴ Staff time drives costs; as such, the City sets development fees and charges based on estimates of the staff time required for the scale of the project and service, for example:

- Fire inspection fees are based on the number of estimated staff hours a project requires.
- Public infrastructure permit fees are based on project value (as a proxy for project scope).
- Plan review appeal fees are fixed amounts based on an estimate of staff time and resources for that process.

These fees then go into the Development Services Fund and the revenues are used to pay for costs – mainly administrative and employment costs – related to providing development services. Staff report that with the current housing crisis, the City has incurred additional costs in analyzing the numerous State laws affecting residential development in addition to making efforts to meet strict timelines set by State law with respect to certain types of residential development.

Customers Pay Most Development Fees at the Time of Permit Application

The development services process starts when an applicant submits an application online and pays an application fee plus inspection fees.⁵ Any fees paid after the issuance of a permit are due to a reinstatement of a permit that lapsed or additional inspections. Exhibit 1 shows a flow chart of the permit application and review process.

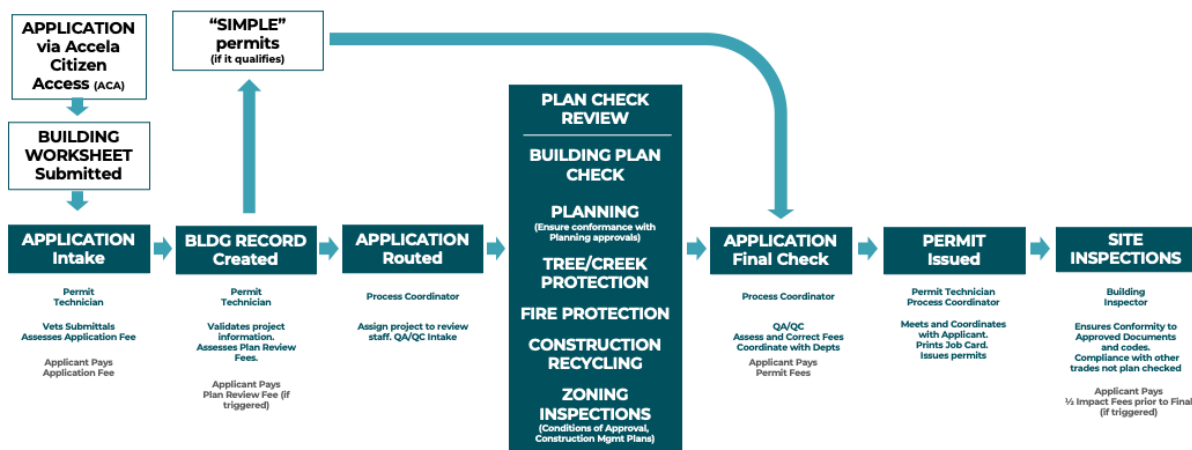
⁴ California courts require that regulatory fees paid be proportional to the cost of services but have not required governments to prove a direct link between expenditures and the receipt of services to the fee payor. As such, the City must make a case that there is a reasonable relationship between the fee and service cost on an overall programmatic basis but not necessarily as to any one specific applicant.

⁵ Other fees not related to the Development Services Fund are also collected at this time, such as impact and school fees.

INTRODUCTION & BACKGROUND

Exhibit 1: Applicants Building New Developments in Oakland Pay Fees to the City, Which Then Reviews the Plans, Issues Permits, and Inspects the Development Project

Building Permitting Process



Source: Planning and Building Department website

The City Separates Development Services Revenue into the Development Services Fund

The Development Services Fund is a special revenue fund. As a special revenue fund, its uses are legally restricted to those reasonably related to services provided to its fee payors. According to its establishing ordinance, the uses of the Development Services Fund are: planning and zoning services, construction inspections and construction permit approvals, building code enforcement, plan check, and engineering services.⁶

The City established the Development Services Fund to account for the revenues and expenditures related to development services. Before the establishment of the Development Services Fund in 2006, development and enforcement activity revenues and expenditures flowed through the General Purpose Fund.

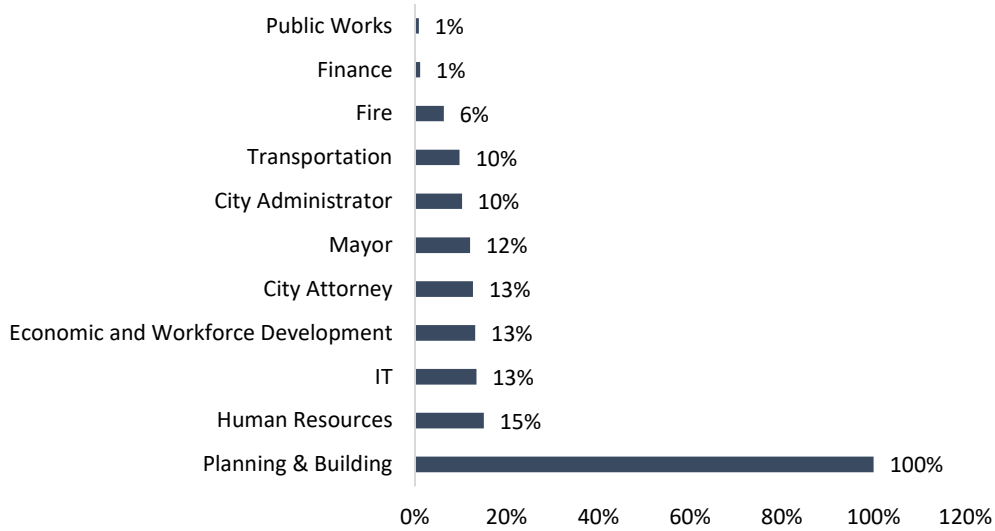
Development Fees Pay for Staff in 11 Departments

Most staff paid with development fees are in the Planning and Building Department, but other departments such as Transportation, Fire, Public Works, and the City Attorney’s Office also fund some staff with revenue from development fees. Exhibit 2 shows the proportion of staff in each department paid for with revenues from development fees.

⁶ 2006 Ordinance C.M.S. 12741

INTRODUCTION & BACKGROUND

Exhibit 2: The Development Services Fund Supports 100 Percent of Planning and Building Staff and Between 1 Percent and 15 Percent of 10 Other City Departments and Offices



Source: Auditor analysis of Position Control Reports as of January 2024.

The Budget Bureau and the City Attorney's Office are responsible for interpreting which department functions may use the Fund based on restrictions within City ordinances, the Oakland Municipal Code, and State law, which restrict the uses of the Fund to expenditures reasonably related to development and enforcement activity.

FINDING 1: Centralizing Development Services Fund Management will Help Ensure it is Appropriately Recovering Costs

Summary

Over the past seven years, the City had relatively high fund balances in the Development Services Fund. At the same time, revenues and workload have varied while expenditures have increased. Additionally, actual expenses came in underbudget, and actual revenues exceeded budgeted revenues. While this appears beneficial, the Fund is intended to only recover costs. Additionally, while the Fund had a peak budgeted cash fund balance of \$113.5 million in FY 2018-19, the Budget Bureau projects the budgeted fund balance will fall to \$37.3 million in FY 2023-24 and to just \$5.4 million in FY 2024-25. Since these are projections, the actual situation may differ, however the increased expenses and variable workload, along with the uncertain revenues, suggest that the City can improve its fund management.

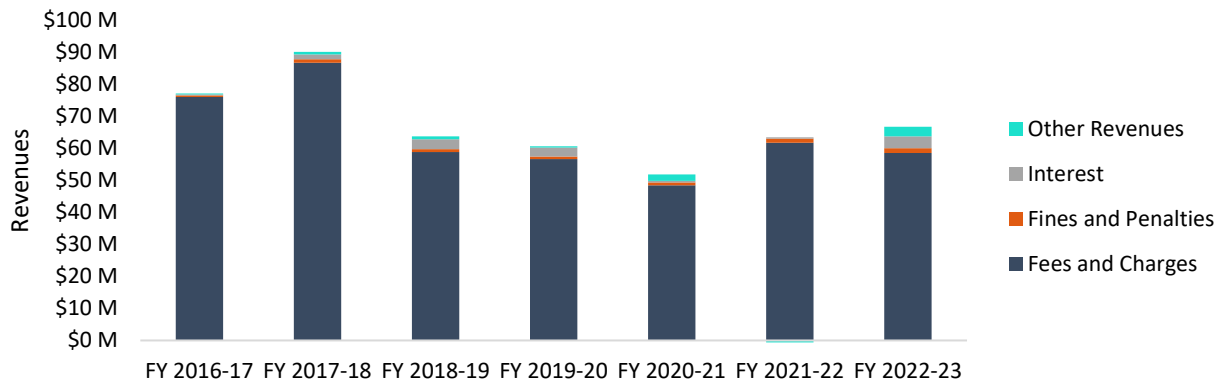
Due to the age and limited coverage of fee studies to date, the City's development fees likely do not tie to the cost of providing service. Because the fees are not 100 percent cost recovery, and the City monitors the fund balance in aggregate (looking at total revenues and total expenses), it is not clear whether the City has enough money within the fund balance to cover incurred costs – that is, the costs of providing services for current development projects that have already paid their fees. Without sufficient fund balance to cover the cost of development services, the City will need to pay for those services with another funding source, likely the General Purpose Fund. Additionally, as described in the Background, most of the expenses from the Fund pay for staff time associated with development services, however, we found the City has increasingly used the Development Services Fund to pay for staff outside the Planning and Building Department.

While the City is working to complete an updated fee study covering development services under the Department of Planning and Building, it can better ensure development fees cover the cost of services by assessing the costs of providing development services by all departments that contribute to and draw from the Development Services Fund. The City should ensure that staff positions that are charged to the Development Services Fund provide services to support development permitting and identify alternative funding sources for any positions that do not provide direct services for development permitting.

Almost All Revenue in the Development Services Fund Comes from Development Fees and Charges, Which Vary with Economic Cycles and Development Patterns

Development fees and charges account for nearly all the revenue to the Development Services Fund, as shown in Exhibit 3. Data from the City's financial management system shows that revenues come overwhelmingly (94 percent) from development fees and charges, with some additional revenue from fines and penalties, and interest. In FY 2022-23, relatively more money came from these revenues, as shown below.

Exhibit 3: Development Services Fund Revenue Ranged Between \$66.7 Million and \$90 Million Over the Last Seven Fiscal Years with Almost All Revenues Coming from Development Fees and Charges

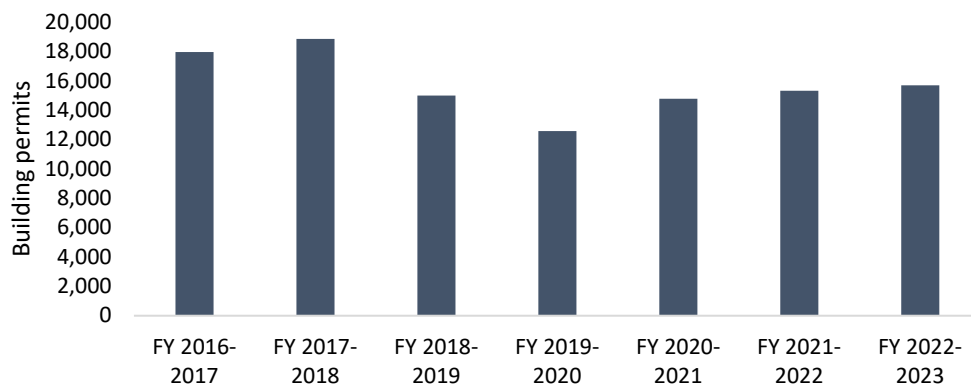


Source: Auditor analysis of Oracle, the City's financial management system. Note: Chart only includes revenue categories that had positive revenue. The negative revenue consisted of a \$2 million unrealized market loss in FY 2021-22.

By Their Nature, Development Service Fund Revenues are Not Steady or Readily Predictable

Since most of the revenues come from development fees, the amount of money the Fund takes in varies with development patterns in the city, which are influenced by market forces such as construction loan and property interest rates, the cost of construction materials and labor, and other factors. Exhibit 4 below shows the number of building permits issued by the City over the past seven fiscal years, which corresponds to the trends in revenue in Exhibit 3 above.

Exhibit 4: The Number of Building Permits Issued Fluctuates with Development Patterns



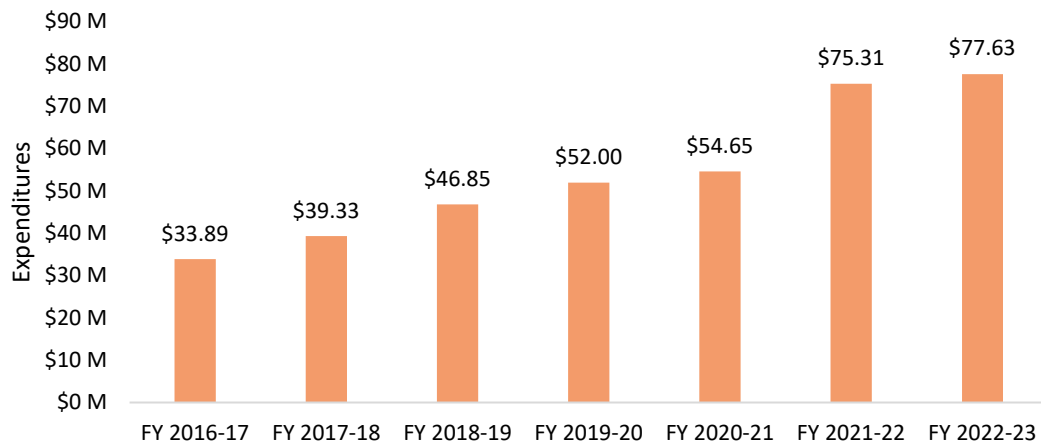
Source: Auditor analysis of data from Accela, the City's development permitting system.

AUDIT RESULTS

While the Number of Permits Issued Has Gone Up and Down, Expenses Have Increased Primarily Due to Staffing

While the workload has varied, expenditures from the Development Services Fund increased each year. Overall, expenditures increased 129 percent between FY 2016-17 and 2022-23, as shown in Exhibit 5.

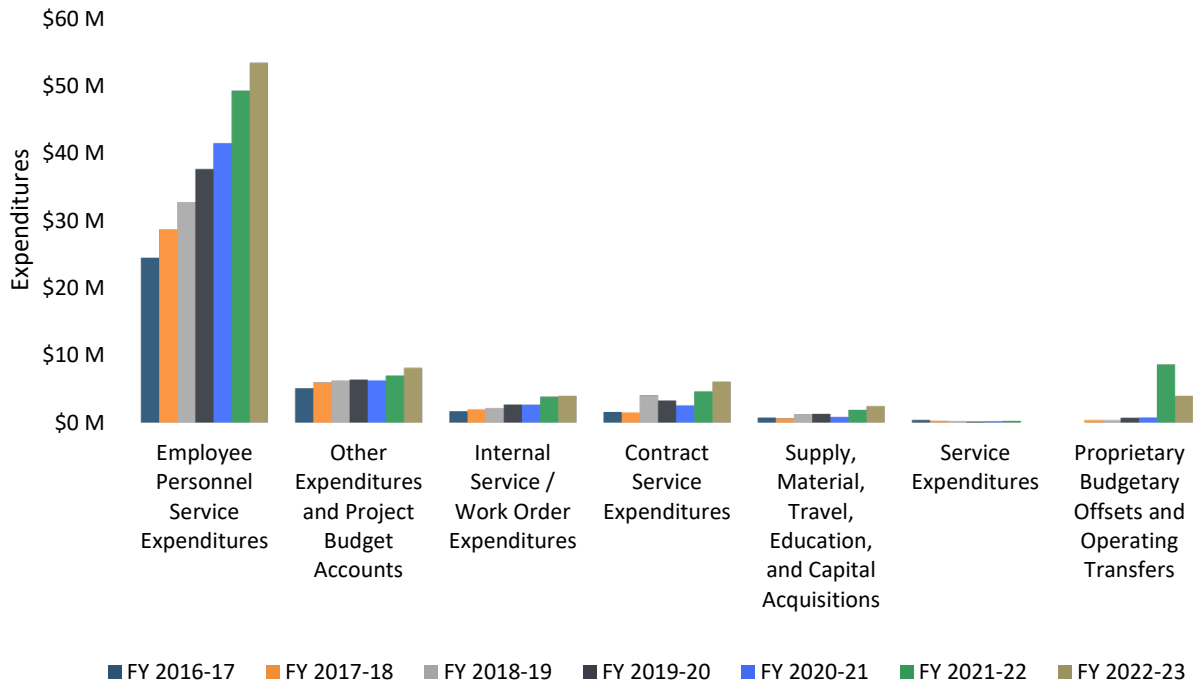
Exhibit 5: Development Service Expenditures Increased 129 Percent Over the Same Period



Source: Auditor analysis of data from Oracle, the City's financial management system.

Revenues in the Development Services Fund mostly pay for the cost of salaries, benefits, and overtime for City staff who work on development service activities. On average, staffing costs made up 71 percent of expenditures over the last seven fiscal years (FY 2016-17 to FY 2022-23, see Exhibit 6). These costs increased across the board, rather than being driven by one-time expenses like overtime or workers compensation.

Exhibit 6: Most Development Service Expenditures Increased, With Most Expenditures Going Toward Employee Personnel Services



Source: Auditor analysis of Oracle, the City’s financial management system.

Note: In FY 2017-18 and 2018-19, payments into the City’s self-insurance fund (found in the proprietary budgetary offsets and operating transfers) cost around \$375,000. Then, in FY 2021-22, the self-insurance cost increased over a thousand percent to \$8.6 million. In FY 2022-23, it decreased to approximately \$4 million. According to staff, this increase was due to large legal claims against the Development Services Fund in FY 2019-20 and FY 2020-21, on top of insurance premiums increasing approximately 15 percent.

The Development Services Fund also pays for contracting third parties for on-call plan check and on-call permit support services to help with peaks in workload and to help meet required timelines under State law for housing development.⁷ Contracting averaged 6 percent of expenditures during the same time period.⁸ Remaining costs include costs like overhead, bank and credit card fees, equipment rentals, printing and administrative services, advertising (for new development notices), posting and mailing, supplies, computers, vehicles, furniture, and a self-insurance liability premium.

The Number of Staff Funded by the Development Services Fund Increased

As of January 2024, Planning and Building accounted for 58 percent, or 209 of 360, of the City’s positions funded by the Development Services Fund. The Fire Department and the Department of

⁷ For example, Government Code section 65852.2 et seq. requires the Planning and Building Department to process Accessory Dwelling Unit (ADU) applications within 60 days.

⁸ Contracted services include blight abatement, on-call inspections and plan check, and updates to the City General Plan, zoning updates, and strategic analysis.

AUDIT RESULTS

Transportation made up 14 and 12 percent of development service positions, respectively. The remaining departments range from less than 1 percent to 4 percent of the total funded positions, as shown in Exhibit 7.

Exhibit 7: Staff in Planning and Building Make Up 58 Percent of Total Citywide Staff Funded by Development Fees

Department	Staff Funded	Percent of Development Funded Staff
Planning & Building	209	58%
Fire	49	14%
Transportation	42	12%
IT	13	4%
City Attorney	11	3%
Economic & Workforce Development	9	3%
Human Resources	9	3%
City Administrator	8	2%
Public Works	6	2%
Finance	2	1%
Mayor	1.5	0.4%
Grand Total	359.5	100%

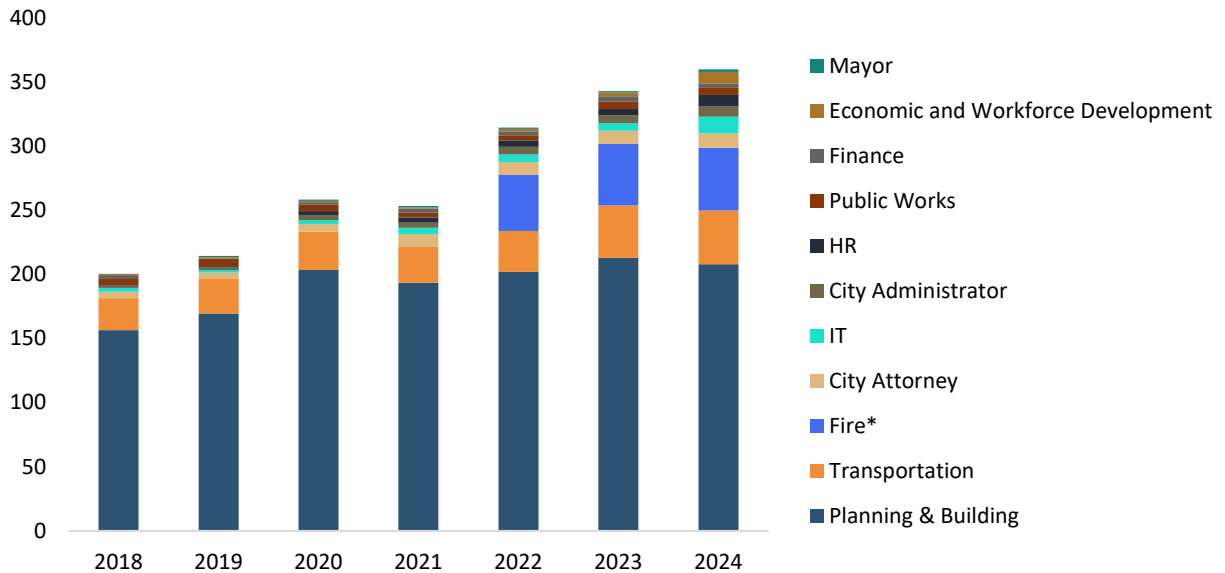
Source: Auditor analysis of the January 2024 Position Control Report.

Development staffing costs more than doubled in seven fiscal years, increasing from \$24 million in FY 2016-17 to \$53 million in FY 2022-23.

Staff Costs Increased in Part with the Inclusion of Fire Prevention Staff as an Allowable Use Starting in FY 2021-22

The increase in personnel costs is due to an increase in the number of staff budgeted through the Fund. The number of staff paid for with development service funds increased from around 200 in 2018 to about 360 in 2024. The City began including Fire Prevention staff within the allowable uses of the Development Services Fund in FY 2021-22. Prior to FY 2021-22, Fire Prevention staff, who review new development for compliance with fire codes including those relating to egress, alarms, and sprinkler systems, were funded by the General Purpose Fund. Fire added 44 employees to the Development Services Fund's cost in FY 2021-22 and 48 employees in FY 2022-23 (see Exhibit 8).

Exhibit 8: The Number of Budgeted City Staff Positions Allocated to Development Services Fund Grew 80 Percent Between 2018 and 2024



Source: Auditor analysis of Position Control Reports for January of each year. Note: Prior to 2021-22, Fire Prevention staff were funded by the General Purpose Fund. The chart does not include \$43,802 budgeted in 2022-23 to cover one-time funding for 20 percent of a senior performance auditor position.

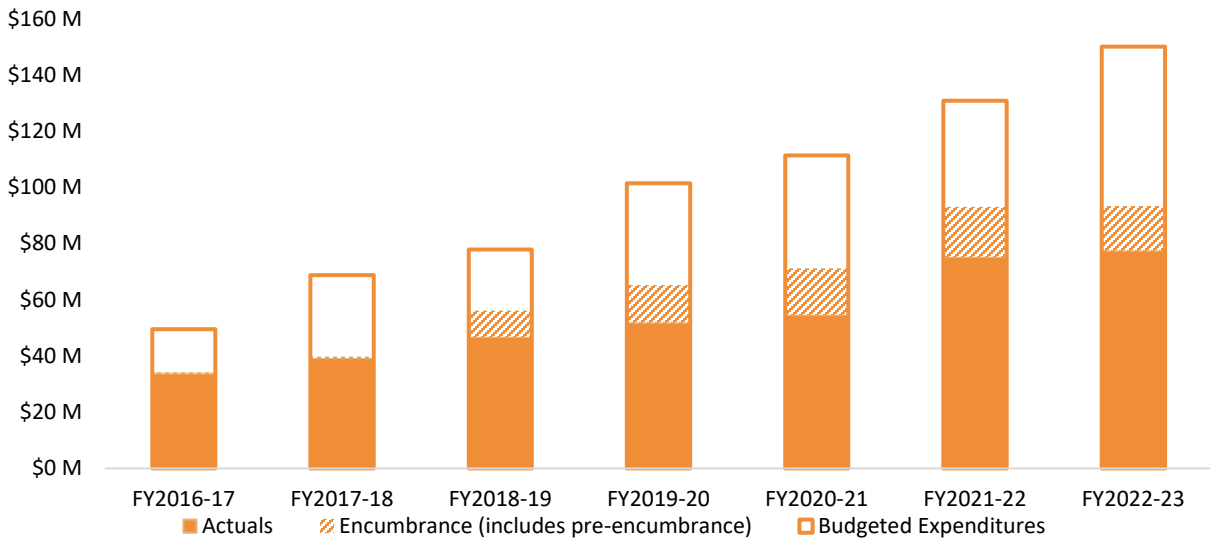
The addition of Fire inspections staffing represents 31 percent of the increase in the number of staff budgeted through the Fund, which increased from 201 in January 2018 to 360 in January 2024 (an 80 percent increase overall). Staffing and staffing costs increased to other departments as well.

Despite the Increased Expenses, the City’s Actual Expenses Have Been Less Than Budgeted Each Year, Due in Part to Vacancies

In the past seven fiscal years, the City’s actual and encumbered expenses were less than budgeted expenses (see Exhibit 9). Staff report that the staff vacancies for positions funded by the Development Services Fund (which created “vacancy savings,” or money not spent) have contributed to expenditures less than had been budgeted. While vacancies have contributed to the underspending, they do not explain the extent. We estimated that vacancies in January 2024, when 102 positions were vacant, for example, would result in an annualized vacancy savings of \$11.7 million.

AUDIT RESULTS

Exhibit 9: Actual Expenditures Have Been Less than the Budgeted Expenditures

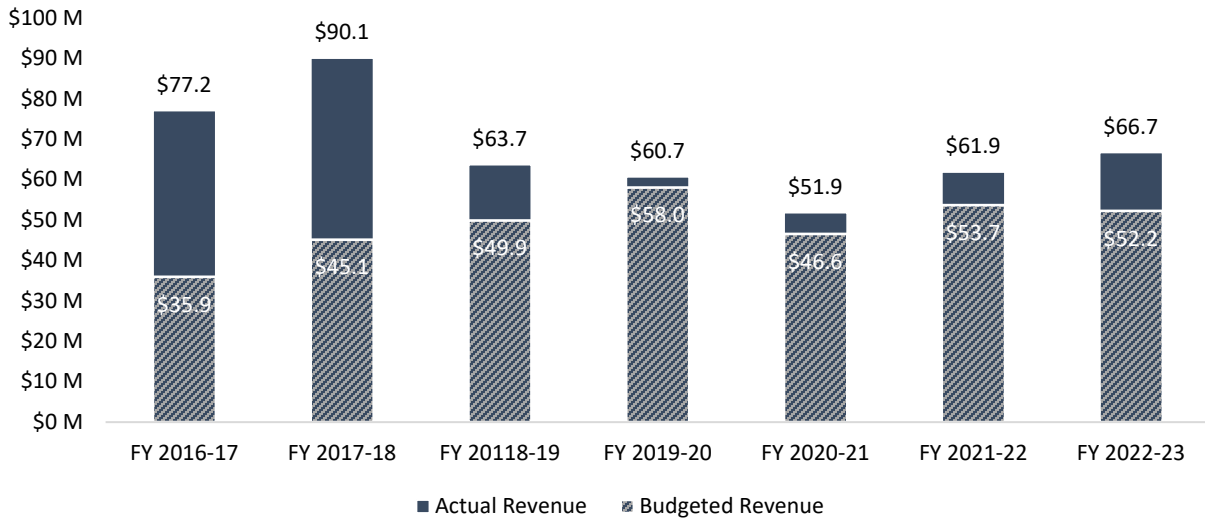


Source: Auditor analysis of Oracle, the City's financial management system.

Revenues Have Consistently Exceeded Budgeted Expectations

The Budget Bureau reports that it bases each year's revenue projection on the previous year's revenue performance and current interest rates. The Budget Bureau also works with individual departments to finalize the revenue projections. For the seven years analyzed (FY 2016-17 to FY 2022-23), actual revenues exceeded expected revenues by \$130.8 million, or 161 percent more than anticipated. Exhibit 10 compares the expected revenue compared to the actual revenue.

Exhibit 10: The City Took in More Money than Expected from FY 2016-17 through FY 2022-23, as Development Service Revenues Exceeded Budgeted Amounts



Source: Auditor analysis of Oracle, the City’s financial management system. Note: The budgeted revenue excludes the transfers from designated and undesignated fund balances, which represent budgetary recognition of previous revenues rather than revenues anticipated in each fiscal year.

The largest differences in the budgeted and actual revenues occurred in FY 2016-17 and FY 2017-18, which exceeded budgets by \$41.2 and \$45 million respectively. Staff reported that in those years, an economic expansion brought in more revenue than expected.

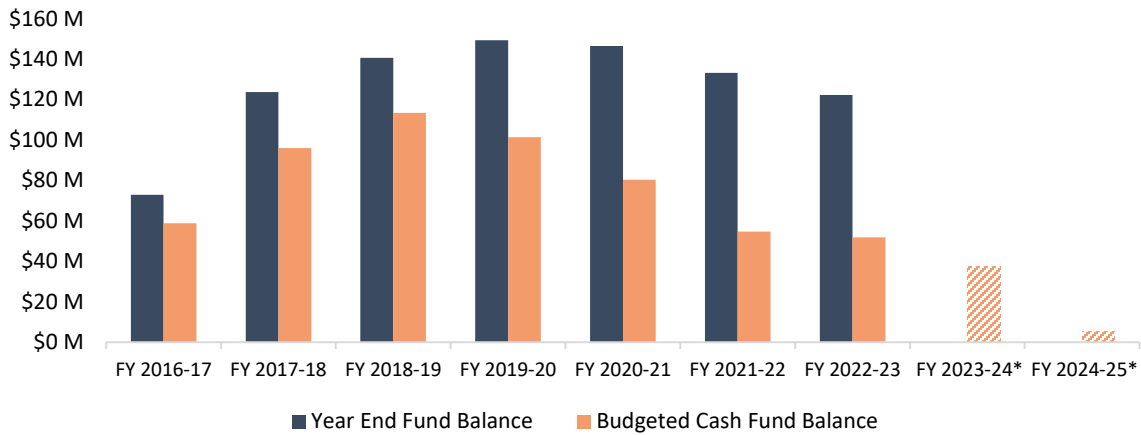
Despite Underbudget Expenses and Revenues Exceeding Expectations, the Development Services Budgeted Cash Fund Balance is Projected to Decrease to a Level that May Not Cover Future Expenses

Over the past several years, the Development Services Fund has had high end-of-year fund balances, but is projected to decrease to a budgeted cash fund balance of just \$5 million in FY 2024-25, as shown in Exhibit 11. The budgeted cash fund balance represents a projection of cash available in the fund at the end of the fiscal year. The year-end fund balance is the actual amount of money that remains in the fund at the end of the year.

The budgeted cash fund balance for the Development Services Fund ranged from \$58.8 million in FY 2016-17 to a high of \$113.5 million in FY 2018-19. The budgeted cash fund balance started to decline following the peak in FY 2018-19. By FY 2022-23 the balance dropped to \$52 million.

AUDIT RESULTS

Exhibit 11: The Budgeted Cash Fund Balance Peaked at \$113 Million in FY 2018-19 and is Projected to Decrease to \$5.4 Million in FY 2024-25



* FY 2023-24 and FY 2024-25 are Budget Bureau projections representing the City’s anticipated fund balance less encumbrance and project carryforwards.

Source: Auditor analysis of Oracle, the City’s financial management system, and the FY 2022-23 Adopted Operating Budget. Note: The budgeted cash fund balance is an estimate and excludes encumbrances and project carryforwards, which represent anticipated expenditures in addition to other expenditures that were not spent in the previous fiscal year. The year end fund balance is the actual amount of money that remains in the fund at the end of the year.

The precipitous decrease in the projected fund balance underscores the importance of fund management when revenues and expenditures are not stable, or readily predictable. The cash fund balance consists of fees that applicants pay upfront for development projects, so it generally represents services yet to be delivered. The City should be able to identify whether there is enough cash in the budgeted cash fund balance to cover anticipated costs. If the fund balance drops such that City cannot cover new or ongoing development projects in progress with the Development Services Fund, it will need to identify an alternative means of funding those services (likely the General Purpose Fund if the fund reserve is unable to cover expenses).⁹

The City Manages the Development Services Fund in Aggregate, So the City’s Liability in Ongoing Project Costs is Not Clear

The separation of the Development Services Fund from the General Purpose Fund in 2006 was intended to allow clearer monitoring of these revenues and their related expenditures, as required by State law.

While the Development Services Fund segregates development service revenues—making it clear how much money the City takes in and spends from the Fund in aggregate—the ability for the City to cover costs associated with the service is unclear, since the fees may not cover the cost of providing services as revenue is booked into the City’s financial management system in the period it is received and some development projects can take years to complete. Because of this, it can be difficult to accurately understand the outstanding workload (and associated staff time and costs) for unfinished projects, or “work-in-progress” liability if the fees do not recover costs.

⁹ Negative balances draw resources from other funds, but ultimately become the responsibility of the General Purpose Fund.

Planning and Building uses a program that has the ability to track the progress and milestones of individual projects. However, the Department does not use this to track project hours or milestones to estimate work in progress or the drawdown on project fees. If project hours and milestones are not tracked and the fees are not fully cost recovery, Planning and Building cannot accurately identify remaining workload and fully understand the available Development Services Fund balance.¹⁰ If the fees are cost recovery, from a budgetary and structural standpoint, this is less of an issue because the balance would represent unfinished work.

Fee Studies Ensure that Service Fees Appropriately Recover Costs

Fee studies ensure fees are limited to the “estimated reasonable cost of providing a service.”¹¹

Because costs change over time, it is a best practice to conduct a fee study every two to five years. The Government Finance Officers Association (GFOA) recommends that governments update fees periodically based on factors such as the impact of inflation, other cost increases (like cost of living adjustments), adequacy of cost recovery, and the use of services.

Oakland Last Implemented Fee Changes Based on a 2015 Fee Study of Planning and Building

The City of Oakland has not revised its development fees based on a fee study in nearly ten years. The goals of the last completed fee study, which was finalized in April 2015, were to:

- define what it cost the City to provide development fee-related services by Planning and Building,
- recommend fee adjustments based on industry best practices, practices of comparable agencies, and the professional opinion of the firm conducting the study,
- develop revenue projections based on recommended increases (or decreases) to fees,
- compile information regarding fees charged by comparable cities, and
- provide user fee models and templates to City staff.

The study found that some fees were set too low and others too high. Overall, the City was collecting at a 68 percent cost recovery rate. The study recommended decreasing fees that were recovering more than 100 percent and increasing fees to collect at a 100 percent cost recovery which would, overall, increase revenue by approximately \$7.7 million per year. Since then, the City has adjusted fees based on changes to cost of living adjustments, but not the changes in service delivery. The City contracted with an independent consultant for a fee study in 2018 but Planning and Building determined it insufficient for use.

¹⁰ The City of San Jose estimates its work-in-progress liability. Like Oakland, San Jose has development projects that take more than one year to complete, and they also collect fees in the year the project starts. Unlike Oakland, when revenues are not spent in the same fiscal year that they are collected, those unused fees are budgeted into a work-in-progress reserve. San Jose further tracks staff time on development projects and uses that to estimate its work-in-progress liability.

¹¹ California Gov. Code Section 17951. Although fees are typically set at or close to 100 percent cost recovery, they may be set lower to encourage participation in a service to be accessible to lower income users as long as this subsidy is not covered by the General Purpose Fund unless a specific policy allows it.

AUDIT RESULTS

To Date, Fee Studies Have Not Covered All Departments Providing Development Services

Other departments that collect development fees have not conducted fee studies. While the Department of Transportation, Fire Department, and Public Works also collect fees and contribute to the Development Services Fund and they have updated their fees based on cost-of-living adjustments negotiated with employee unions, these adjustments may not reflect the full cost of services without a fee study. For example, a 5-percent cost of living adjustment for employees was implemented in July 2022, but a year lapsed before the cost of living adjustment took effect for charges and fees in June 2023. This delay caused an undercharging of fees of approximately \$3 million.

The City is Working to Complete a Planning and Building Fee Study in 2024, With a Follow Up Study on Other Departments Within the Next Year

The Planning and Building Department plans to complete a fee study in 2024 to detail fee activity, complete a comprehensive review of current fees, and gain an understanding of the current and future development environment. This study, and subsequent changes to the fees charged, will help to ensure the City recovers costs for the services it provides and should help improve budget projections.

Additionally, the City Administrator's Office reports that the City is scoping a supplemental study to cover development fees charged by the Department of Transportation, the Fire Department, and Public Works, IT, Economic and Workforce Development, and the City Administrator's Office. It is important that the City complete and enact fee changes for *all* departments that contribute to and draw from the Development Services Fund to ensure the integrity of the Fund overall. Without covering all expenses associated with the services, the Fund cannot be cost recovery. For example, in FY 2022-23, development fees and charges totaled \$58.6 million. Of that, Planning and Building collected 77 percent or \$44.8 million and the other three departments that collect fees and charges made up 23 percent, or \$13.7 million of the total collected. This means almost \$14 million in fees and charges are not based on a fee study and may not cover the cost of services.

Other cities implement regular review through policy. For example, the City of San Diego has a User Fee Policy which states that in-depth user fee studies should be undertaken every two to five years, with annual adjustments based on certain economic indicators or changes in budget allocations.

Recommendation 1: The City Administrator's Office should issue a policy to have periodic development service fee studies to cover all departments that contribute to and draw from the Development Services Fund to ensure the fees meet cost recovery goals and the expenses it covers are reasonably related.

Development Services Fund Expenses Should Relate Directly to Service Delivery

Most of the expenses from the Fund pay for staff time associated with development services; however, we found the City has increasingly used the Development Services Fund to pay for staff outside the Planning and Building Department. As shown in Exhibit 12, the number of staff funded

in the IT Department, City Administrator’s Office, Human Resources Management Department, City Attorney’s Office, and the Economic and Workforce Development Department have increased several times over. To fully recover costs, the City should ensure the indirect costs associated with development services are included within the fee, while limiting any expenses that do not support the service. Indirect costs may include costs associated with support services like those offered by IT, the City Attorney’s Office, and Finance. For example, the ordinance establishing the Development Services Fund specifically disallows the use of the Fund to cover workforce development and other costs.¹²

Exhibit 12: The City Has Increasingly Used the Development Services Fund to Pay for Staff Outside the Planning and Building Department

Department	2018	2019	2020	2021	2022	2023	2024
Planning & Building	157	170	204	194	202	213	208
Transportation	25	27	30	28	32	41	42
Fire	0	0	0	0	44	48	49
City Attorney	5	5	6	10	10	10	11
IT	3	2	3	5	6	6	13
City Administrator	1	2	4	4	6	6	8
HR	1	1	3	4	5	5	9
Public Works	5	6	5	4	4	6	6
Finance	3	0	2	3	3	4	3
Economic & Workforce Development	1	1	1	1	2	3	9
Mayor	0	1	1	1	1	1	2
Total Positions	201	215	259	254	315	343	360

Source: Auditor analysis of Position Control Reports for January of each year.

The City should evaluate the appropriateness of the positions funded, including those in departments that provide development services, to ensure that the fees charge an appropriate amount for indirect and direct service delivery, and those costs are identified within the fee study and fee structure. To ensure the structural integrity of a cost-recovery fund, the City should identify alternative funding sources for positions that are not covered by the fee. The City Administration has indicated that an upcoming supplemental study will cover development fees charged by the Department of Transportation, the Fire Department, and Public Works, IT, Economic and Workforce Development, and the City Administrator’s Office will update and align staff funded with development service funds.

¹² 2006 Ordinance C.M.S. 12741 section 3(g)

AUDIT RESULTS

Recommendation 2: The City Administrator should coordinate with the City Attorney to establish criteria for what types of staff may be funded by the Development Services Fund, review the appropriateness of using the Development Services Fund to pay for positions, and identify alternative funding sources for any positions that do not provide direct services for development permitting, or are disallowed under the ordinance establishing the Development Services Fund.

OBJECTIVES, SCOPE & METHODOLOGY

Objectives

To identify reasons for the high year-end balances of the Development Services Fund.

Audit Scope

The scope of the audit includes FY 2016-17 through FY 2022-23 for analyzing and testing for appropriateness and comparison to development trends. We included staffing figures up to January 2024 and forecasted budget projections for FY 2023-24 and FY 2024-25 for informational purposes and relevance.

Methodology

The objective of this audit was to identify the reasons for the high year-end balances, as described above. To this end, we reviewed management controls relevant to the objective and:

- Reviewed the ordinance creating the Development Services Fund to understand the mandates of the ordinance.
- Obtained and analyzed revenue data from the City's financial management system to understand the sources and allocation of the revenue collected.
- Obtained and analyzed expenditure data from the City's financial management system to understand cost categories and trends in expenses.
- Obtained and analyzed the City's position control reports to understand the type, number, and proportion of City staff funded by the Development Services Fund.
- Interviewed staff in Planning and Building and the Budget Bureau to understand relevant processes and procedures.
- Reviewed City Council meetings and reports to collect information and City Council actions directly related to the Development Services Fund.

STATEMENT OF COMPLIANCE

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The table below highlights some of the building fees an applicant would pay to pull a permit. For a full listing of all fees, see the FY 2023-24 Master Fee Schedule [here](#).

Permit Application	
Building, Electric, Mechanical Plumbing Permits	\$79 Permit
Document Research Fee	\$72 per hour
Processing Security Deposits (surety bonds, cash, checks, etc.)	\$390/each
Zoning Sign-Off	\$81 sign-off
Engineering	
Review of Private Infrastructure Permit	\$336 to \$77,415+ (based off the construction value)
Review of Plan Revisions	\$284 per hour (regular work hours)
Construction Site Monitoring	\$2,947 for Plan Review \$970 to prepare agreements (stormwater, etc.)
Inspection	
Inspection Fee (issuance of a permit for new construction)	\$273 to \$3,284+ (based off the construction value)
Solar Electric Installation	\$487 inspection for residential \$1,081 inspection for commercial
Window Replacement	\$124 (1 to 10 windows) \$273 (11 to 100 windows) \$408 (101+ windows)
Electrical, Mechanical, & Plumbing Inspection Fee for new construction	15 percent Minimum \$123 of building permit
Fixture inspections	\$57.20 plumbing fixture \$21.60 garbage disposal residential \$572 swimming pool \$247 furnace \$196 range hood commercial
Plan Check	
Front counter support	\$95 per ½ hour
Site plan review	\$747 plan
Driveway permits	\$139
Soft story retrofit	\$477

Source: Auditor summary.

CITY ADMINISTRATION'S RECOMMENDATION IMPLEMENTATION PLAN



Office of the City Auditor

Performance Audit of the Development Services Fund

City Administration's Recommendation Implementation Plan

Rec#	City Auditor's Recommendations	Management Action Plan	Responsible Party	Target Date for Completion
1	The City Administrator's Office should issue a policy to have periodic development service fee studies to cover all departments that contribute to and draw from the Development Services Fund to ensure the fees meet cost recovery goals and the expenses it covers it are reasonably related.	The first citywide development services fee study contract was authorized by City Council on May 6, 2024 per Resolution No. 90213. The citywide policy will be memorialized in an update to Administrative Instruction No. 19: Master Fee Schedule.	City Administrator	December 1, 2024
2	The City Administrator should coordinate with the City Attorney to establish criteria for what types of staff may be funded by the Development Services Fund, review the appropriateness of using the Development Services Fund to pay for positions, and identify alternative funding sources for any positions that do not provide direct services for development permitting, or are disallowed under the ordinance establishing the Development Services Fund.	The City Administrator is coordinating with the City Attorney and incorporating the criteria into the scope of work for a contract currently under negotiation and authorized under the Resolution approved by City Council on May 7, 2024, per Resolution No. 90213. The City Attorney has determined there are no positions disallowed under 2006 Ordinance C.M.S. 12741.	City Administrator	Complete