



## Weathering Fluctuations in Building Permit Revenues

By Bruce Cowans and Jerry Wolf

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Economic fluctuations make it difficult for governments to break even on the cost of providing building permits, which are required in most states. Rates are based on anticipated demand, which is difficult to predict. Boom-and-bust cycles often result in either too much or too little revenue. A surplus may lead to legal trouble, while a revenue shortfall may result in budget and service cuts.

Building departments are usually funded via permit fees paid by builders. Most building departments are part of the general fund, but many operate as enterprise funds. These departments offer a variety of services that may include site planning, plan review, trade permits, storm water drainage plans, arborist review, zoning, septic and well, and sediment control.

The major expenses for any building departments are personnel related — relatively fixed costs that can be forecast with a high degree of certainty. Annual revenue, in sharp contrast, is highly variable, boiling down to demand, or how many builders submit applications in a given year. This number may fluctuate significantly over time. Based on U.S. Census data from 2000 to 2014, the number of residential permits was 25.9 million in 2005, 7 million permits in 2009, and 12.6 million in 2014.

Over this volatile 14-year period, during times of low permit volume, many departments were forced to cut staff. Some departments even went through multiple rounds of staff reductions as they sought the optimal staffing level. When applications picked up with the economy, the same departments needed to recruit and train new staff to handle zoning reviews, plan reviews, and onsite construction inspections.

Though building permit departments have started to process more applications, they have not increased staff at a comparable rate. There are two reasons: 1) competing for experienced staff with technical skills in construction and trades is difficult in a relatively strong economy, and 2) building departments have taken advantage of computerized tools that can streamline the plan review and inspection processes. Automation has allowed for electronic plan submission and mobile applications for scheduling and reporting on inspections.

A surplus comes with its own set of problems. Revenues in excess of costs leaves permit departments open to challenges over their fees. Further, local governments are not in the profit-making business. Taxpayers and other customers want to pay as little as possible for efficient and effective public services. Nationally, governments are

being challenged about the amounts of the fees they charge. Legislation and case law in many states require governments to set user fees so that revenues don't exceed the cost of the service.

## PREVENTING FLUCTUATIONS

There's little that building-permit departments can do about external factors like the economy and the ever-changing demand for permits. However, following best practices can help your department better plan for and accommodate shifts in revenue when — not if — they arise. Whether the local standard is at the department, service, or individual permit level, building permit departments should know how their fees and costs are aligned. In most cases, this matching of costs and revenues is done at the department or fund level. In some cases, the test is at a broad service level (e.g., "Are the revenues of one class of customers subsidizing the cost of serving another class of customers?") In other cases, challenges have been made at the individual permit level (e.g., "Were the fees charged to Applicant A equal to the cost of serving Applicant A?").

**Know the True Cost of Every Service.** This is the basis for any fee-setting discussion. It doesn't matter if the permit department is a General or Enterprise Fund agency: your department must recognize all permit-related costs. When departments or divisions may support the permitting process, the related costs must be identified (e.g., reviews or inspections by personnel in fire, zoning, planning,

water management, public works and arborists). Also, don't ignore centrally funded administrative costs like human resources, finance management, and office space.

**Develop a Policy for a Reasonable Fund Balance.** Use the Goldilocks principle: the size of the reserve shouldn't be too big or too small. It needs to be just right. If the reserve is too large, there may be legal repercussions, or permit applicants may complain about being overcharged. If the reserve is too small, then sudden drops in permit volume and revenue will quickly deplete the fund balance before the local government can react, either by reducing costs or increasing fees.

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But what is "just right?" Three months is a good rule of thumb. Ideally, the surplus should allow the department to support operations through the next budget cycle.

**Budget Appropriately for Long-Term Commitments.** There may

be times when your department has received permit fees that haven't yet been "earned," in which case they should not count as revenue. For example, adjustments must be made for large commercial projects that take longer than a year to complete. Recognition of permit fees should be matched to the length of the project, reflecting the commitment of staff; otherwise, it will look like the department has no revenue to support the project. Another example would be land development projects for which the state requires periodic inspections. When permit fees are paid in advance, they should be matched with the inspection cycle. When the entire fee for a four-year cycle is paid upfront, just 25 percent of the fee should be recognized as revenue each year.

**Calibrate Rates so Permit Volume Meets Revenue Requirements.** Revenues and expenses rarely match. Whether you base rates on square footage, actual construction costs, or industry indexes for construction cost per square foot for types of construction, you won't know the volume of work completed until after the end of the fiscal year. Differences between estimated and actual revenue should be factored into future rate-setting discussions. Avoid announcing rate-setting changes that will affect the flow of applications. If the permitting department announces a rate change that will take effect in 60 days, applicants may speed up or delay submitting applications because of rate increases or decreases.

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**Develop a Plan for Translating Surplus Revenue into Service Improvements.** Revenue surpluses should be funneled into improved customer service (e.g., improved processes, facilities, training, and automation). This plan should address the way

all building permit-related services are offered. Many governments are adopting a “one-stop shop” model where all permitting functions, even those offered by different departments, are in the same place. Instead of visiting offices in different locations, customers can visit one site, apply for permits at one location, and pay permit fees in a single transaction.

### CONCLUSIONS

Setting rates for building permits is difficult, and governments have to balance the potential for excess revenue or shortfalls. Jurisdictions need to take several steps minimize these fluctuations. They need to start out by knowing the true

cost of every service involved in issuing permits. It’s also important to develop a policy for what counts as a reasonable fund balance. The government also needs to budget appropriately for long-term commitments, calibrate its rates so the volume of permits issued meets the department’s revenue requirements, and develop a plan for putting any surplus revenue generated into improved service for its customers. |

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