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**Policy Title: User Fees and Subsidies Policy**

**Policy Number: CFO010**

**Report Number: FCS2008-13, PFC2012-16**

**Approved by: Council**

**Effective Date: 2008 April 28, amended 2012, February 27**

**Business Unit: Chief Financial Officer's Department**

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### **BACKGROUND**

User fees are fees that The City of Calgary charges in exchange for goods and services. User fee revenues represent a significant portion of The City's total operating budget. A consistent approach to setting user fees is necessary to protect and anticipate this important revenue source, as well as to ensure that the necessary information is available to inform decisions regarding user fees.

This policy updates the User Fees Policy that was approved by Council in 2008 April 28 (FCS2008-13), following Council's direction in 2011 September 19 to bring forward appropriate wording with the intent to add a new policy goal to the User Fees and Subsidies Policy (C2011-77).

A discussion paper entitled, Underlying Principles Guiding User Fees & Subsidies Review, is available to give more in-depth description and analysis regarding the principles that form the basis of this policy. Definitions of terms used in this policy are included at the end of the policy.

### **PURPOSE**

The purpose of this policy is to provide a framework for decisions related to the pricing of user fees. It sets out guidelines for the process, rationale and the information needed to support the recommended user fees. This policy applies to goods and services provided by City Business Units for which a user fee is charged.

This policy will lead to consistent and transparent decision-making regarding user fee pricing. This will help to protect this valuable revenue source while also ensuring that user fees accurately represent the value of the goods and services to citizens.

## **POLICY**

### **Guiding Principles**

The following principles underlie the User Fees Policy.

*Principle 1 - Benefits Principle: those who receive benefits from a particular municipally provided good or service should pay for that good or services according to the level or value of the benefit received.*

The benefits principle indicates that for goods that have an individual private benefit to the consumer, it is appropriate to consider user fees as a way of matching the payments with the benefit received. Properly priced user fees are the most direct means of matching payment with the benefit received.

User fees should only reflect the proportion of the total benefit that is represented by the individual private benefit. Where consumption of a good has a public benefit, broad based tax support reflecting the benefit to all and paid through taxes should be considered. This is discussed further below under the concept of general tax support.

*Principle 2 - Cost Recovery Principle: the full cost of providing a good or service, including operating expenses, administrative costs, capital expenses (including depreciation), as well as implicit costs of foregone opportunities or activities that are not being undertaken, environmental costs and social costs, should be the starting point when calculating the appropriate user fee.*

The cost recovery principle does not imply that all costs incurred need to be recovered through user fees; rather, it suggests that even if the full costs are not recovered through user fees, understanding the full costs should be the starting point in setting the appropriate user fee. Thereafter, explicit decisions can be made, including decisions regarding the level of subsidization of the good.

*Principle 3 - Management of Public Assets Principle: public assets have a value and The City has a responsibility to recognize this value and protect these assets.*

When assets are used to provide publicly available goods, then proper management of these assets implies that they will be utilized so that the public receives the greatest total benefit. This principle recognizes that public assets have a value and that this value should be considered when determining rates for user fees. Lifecycle costs should also be considered when determining user fees in order to ensure that the values of the assets are protected.

*Principle 4 - Allocation of Resources Principle: in an environment with limited resources available and increasing public demand for goods and services, user fees have value as a mechanism for allocating scarce resources.*

Charging a fee can also be used to manage the timing of demand for a service. Many goods offered by The City have higher demand during peak periods. Building capacity to meet peak demand implies there is under-utilized capacity during the off-peak periods. Implementing price differentials can help to balance the demand for goods between peak and off-peak periods. Charging higher prices during peak periods can encourage people to consume during off-peak times while generating greater efficiency in the use of infrastructure.

*Principle 5 - General Tax-supported Subsidies Principle: when consumption or use of a good or service benefits society as a whole, all citizens should pay for the societal benefit.*

Government is in a unique position to achieve the societal benefits principle through general tax support. If society as a whole benefits from an activity, then society as a whole should pay the proportion of the costs of that activity that reflects the societal benefit. The City collects money from citizens through the tax system and is able to provide subsidies to the activities which benefit society at large.

At times, societal benefits associated with a good, such as transit, come not in the form of benefits per se, but rather as a reduction of social costs. The most equitable means of remedying a social cost is to require individuals to pay for the negative impacts of the activity. This is often done through selective taxation and regulation. However, when the cost is not fully reflected in the price of the good, then encouraging the consumption of substitute goods or services that reduce social costs may be appropriate. This can be achieved through general subsidization of a substitute good, which reduces the price and increases consumption of the substitute good. In turn, this reduces consumption of the activity with the higher social cost and results in reduced social costs.

*Principle 6 - Tax-supported Subsidies for Individuals Principle: in cases where individuals may have resources below an acceptable level and are not able to make the choice to consume and pay for City goods and services, The City could provide a subsidy to the individual in order that they are allowed the choice to consume.*

In contrast to the general tax support subsidies which are based on the benefits principle, individual tax support subsidies are provided on an individual basis and apply only to those who meet stated criteria

## **Policy Statements**

### **General**

- 1) Each good or service provided by The City should be classified into one of four categories. Each category identifies different levels of individual and societal benefits received. User Fees are appropriate for goods and services that are classified as either i), ii) or iii) below. The categories for goods and services are:
  - i) **Non Tax-Supported** - A non tax-supported good or service is a good or service for which user fee revenues, in an average year, are expected to recover the full costs of production. A good or service potentially falls within this category if the benefit from consumption accrues only to the user and a user fee can be charged. This category replaces the Private Good category in the 1995 User Fees Policy;

- ii) **Partially Tax-Supported** - A partially tax-supported good or service is one for which user fee revenues are expected to recover only a portion of the full costs of production. The costs not covered through user fees are subsidized through tax revenues. A good or service potentially falls within this category if the benefit from consumption accrues to both the user as well as to society as a whole and a user fee can be charged. This category replaces the Merit Good category in the 1995 User Fees Policy;
  - iii) **Licenses, Permits and Approvals** – Licenses, permits and approvals constitute permission granted by the municipality allowing property owners to use their property in the specified manner. This category replaces the Regulatory Good category in the 1995 User Fees Policy; or
  - iv) **Fully Tax-Supported** - A fully tax-supported good or service is one for which the full costs are recovered through taxes, therefore no user fees are charged. A good or service potentially falls within this category if the benefit from consumption cannot be easily ascribed to an individual or a user fee is not practical or desirable. This category replaces the Public Good category in the 1995 User Fees Policy.
- 2) User Fees are only appropriate where The City is willing and able to exclude customers for non-payment in a way that is both legally and administratively feasible, as well as socially desirable.
- 3) No User Fee should be applied without a full consideration and analysis of subsidy options.

### ***Pricing Methodology***

- 4) Each user fee should be supported by a pricing methodology for calculating the user fees. The pricing methodology will form the basis for business units to set the user fee for each good or service.
- 5) Pricing of user fees should conform to the Municipal Government Act and any other relevant legislation.

### ***All Goods and Services***

- 6) The methodology for calculating prices for all goods and services should consider:
  - a) an estimate of the full cost of producing the good or service. The full cost of producing the good or service will include:
    - i) all direct and indirect operating costs;
    - ii) all capital costs. The capital costs include amortization of any debt, depreciation and lifecycle costs and a return on capital;
    - iii) estimates of environmental and social costs; and

- iv) corporate overhead costs
- b) a demand analysis for the good or service;
- c) an estimation of the value of the good or service to consumers;
- d) an estimation of the value of the societal benefit associated with the consumption of the good or service;
- e) identification of whether GST is included in the published price or excluded from the published price. GST should be excluded unless there is a supported business reason for including GST;
- f) a consideration and analysis of the existing market price, if applicable;
- g) an analysis of the potential use of convenience pricing for the good or service; and
- h) identification of differential pricing strategies. Differential pricing strategies include:
  - i) peak-load pricing;
  - ii) amenity-based pricing;
  - iii) pricing based on location;
  - iv) pricing based on customer class;
- i) the rationale for differential pricing. Acceptable rationales for differential pricing are cost differentials, demand management practices, standard business practices (e.g. revenue/profit maximization) and differentials in the societal benefit; and
- j) provisions to change prices in the intervening years reflecting impacts such as cost inflation and convenience pricing.

***Non Tax-Supported Goods and Services***

- 7) In addition to the inclusions in 6) above, the methodology for calculating prices for non tax-supported goods and services should consider:
  - a) full cost recovery, including capital depreciation;
  - b) profit maximization pricing strategy where legally permitted; and
  - c) differential pricing to different customer classes, particularly where these reflect the standard business practice for the good or service. Customer classes may be defined on any discernable characteristic that is legally allowed but should be restricted to those for which the administration costs are relatively low.

## ***General Tax Support for Partially Tax-Supported Goods and Services***

- 8) In addition to the inclusions in 6) above, the methodology for calculating prices for partially tax-supported goods and services should consider:
- a) the societal benefit attributed to the consumption of the good or service as well as a general subsidy that reflects an estimate of the value of the societal benefit. The societal benefit and corresponding tax support should be determined such that:
    - i) the societal benefit represents the environmental, social and economic external benefits associated with consumption of the good or service, as defined by the 12 policy goals for assessing societal benefits, approved by Council in report PFC2012-16. These goals are consistent with The City of Calgary's Triple Bottom Line policy LUP003, EM003 CS003.
    - ii) the tax-supported subsidy will be presented as a range to allow flexibility between review periods. Unless otherwise justified, this subsidy should be presented in terms of a percentage of the full cost of producing the good or service;
    - iii) differential general subsidies may be attributed to different customer classes provided they are supported with a detailed analysis; and
  - b) differential prices for non-residents. However, an analysis should be provided that considers the administration costs involved in enforcing the differential prices, the potential impact on other partially and fully tax-supported goods and services and any legal considerations associated with the implementation of differential prices for non-residents.

## ***Licenses, Permits and Approvals***

- 9) In addition to the inclusions in 6) above, the methodology for calculating prices for licenses, permits and approvals of goods and services should consider:
- a) deviation from full cost recovery for licences, permits and approvals in situations that involve the explicit encouragement or discouragement of specific activities. A full analysis detailing the impact of price on the encouragement or discouragement of the activity should be included with the pricing methodology, along with a subsidization strategy if less than full cost recovery is used; and
  - b) rationalizing penalties for non-compliance with the price of licences, permits and approvals to ensure they provide a sufficient deterrent for non-compliance.

### ***Tax-Supported Subsidies for Individuals***

- 10) User fees should be accompanied by a documented strategy for subsidies to qualified individuals. This strategy should include:
- a) identification of any individual subsidies which may apply to the goods or service, and whether the subsidy is the result of a City-wide subsidy program or specific to the good or service. Individual subsidies should be consistent with The City's Fair Calgary Social Policy CSPS034;
  - b) the criteria for receiving an individual subsidy and identification of the application process for receiving an individual subsidy. The criteria and application process should be consistent with The City's Fair Calgary Social Policy; and
  - c) an analysis of implementing a sliding benefit for individual subsidies. Any sliding benefits that are implemented should be consistent with The City's Fair Calgary Social Policy.

### ***Policy Review***

- 11) The principles and policy statements should be reviewed every 10 years

### **POLICY GOALS FOR ASSESSING SOCIETAL BENEFITS**

The 12 policy goals for assessing societal benefits are:

Policy Goal  
No.

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|----|---|
|    | <u>Environmental:</u>   |
| 1  | Reduce community greenhouse emissions, air pollutants, and energy consumption                               |
| 2  | Protect water resources   |
| 3  | Ensure land stewardship & protection  |
| 4  | Reduce waste to landfill  |
|    | <u>Social:</u>  |
| 5  | Provide accessibility/availability  |
| 6  | Enable affordability  |
| 7  | Promote accommodation/acceptability   |
| 8  | Improve adequacy to meet need, suitability and safety   |
|    | <u>Economic:</u>  |
| 9  | Create a city where citizens want to live, work and invest  |
| 10 | Create a city that promotes a healthy, vibrant economy by attracting, retaining and helping businesses grow |
|    | <u>Smart Growth:</u>  |
| 11 | Encourage sustainable communities   |
| 12 | Reduce barriers to participation.   |

## **PROCEDURES & RESPONSIBILITIES**

### **Council will approve:**

- the policy and any updates and amendments to the policy; and
- all user fees as part of the Business Planning and Budget Cycle process.

### **Administration will be responsible for:**

- reviewing the principles and policy statements and recommending any updates and amendments to the policy;
- conducting and maintaining a corporate capital and support service costing study;
- recommending user fees based on the relevant pricing methodology; and
- developing pricing methodologies for user fees for those goods and services that they provide.

## **DEFINITIONS OF TERMS**

Amenity-based pricing	Basing price on the amenities contained within each facility rather than setting a uniform price for all facilities.
Average cost pricing	Setting price equal to the average cost of producing the good.
Capital cost	The cost of buildings and equipment as well as the costs related to the financing of buildings and equipment.
Convenience pricing	Pricing that takes into account the convenience of the monetary units needed to pay for the good (e.g. rounding to the nearest quarter or dollar).
Cost	Any resource required to engage in an activity.
Customer class	A categorization of customers based on an identifiable characteristic common to all customers in the class.
Demand analysis	An analysis of the market demand for a good and service that relates the impact of price changes to changes in total revenues and costs.
Differential pricing/Market segmentation pricing	The practice of setting different prices for different consumers of a good, depending on the characteristics of the consumers.
Direct costs	Costs that can be assigned to individual activities in the production of specific goods and services.

Full cost recovery	Setting price for a good or service such that revenues generated are sufficient to fund all costs related to the production of the good.
Fully tax-supported good	A good or service that is funded entirely through taxes and therefore no user fee is charged. Goods and services that fall into this category are typically equally available to all consumers, non-rivalrous (i.e. consumption by one consumer does not interfere with the availability to other consumers), non-exclusive (i.e. no one can be excluded from consuming it), and the benefits are shared by a large number of consumers.
General subsidy/General tax support	A subsidy that reduces the price of a good or service for all consumers.
Group subsidy	A subsidy that reduces the price of a good or service to all members of an identifiable group.
Incremental cost pricing	Setting the price of a good or service for a secondary market equal to the total the cost of producing it for the entire market less the cost of producing it for the primary market.
Indirect costs	General costs required to operate the Corporation but cannot be assigned to individual activities in the production of specific goods and services (e.g. overhead costs).
Individually targeted subsidy/ Individual tax support	A subsidy that reduces the price of a good or service for individuals that meet specific criteria.
Licenses, Permits and Approvals	Permission granted by the government for an individual to engage in an activity, allowing property owners to use their property in the specified manner.
Lifecycle cost	The costs associated with the maintenance and replacement of physical capital (i.e. buildings and equipment) in order to ensure the maximum life use from the capital.
Market competitive pricing	Charging a rate/fee similar to that charged by suppliers of similar products.
Multi-part tariff	A fee that is comprised of a fixed flat rate plus a variable use-related charge.

Non tax-supported good	A good or service for which user fee revenues, in an average year, are expected to recover the full costs of production. Goods and services that fall into this category typically benefit only the consumer, are rivalrous (i.e. consumption by one consumer impedes the availability to other consumer) and are exclusive (i.e. people can be excluded from using it).
Partially tax-supported good	A good or service for which user fee revenues are expected to recover only a portion of the full costs of production with the balance of the costs funded through taxes. Goods and services that fall into this category are typically rivalrous and exclusive, but the benefit of consumption accrues to both the consumer as well as a larger part of society. Because of the latter benefits, society (usually government), deems the good undervalued by consumers in normal market exchanges.
Peak load pricing	The practice of setting a price higher during periods of high demand and lower during periods of low demand.
Pricing Methodology	The general process and criteria used in determining the price of a good or service.
Profit maximizing price	A price that is set with the goal of generating the highest level of profit (revenues less costs) possible.
Regulatory good	Permission granted by the government for an individual to engage in an activity.
Societal Benefit	A benefit to society at large that is derived from an individual's consumption of a good or service. These benefits can be external economic, environmental or social benefits.
Subsidy	The portion of production costs that is recovered through taxes or other revenue sources rather than by the sale of the good or service in order to keep the price of the good or service at a desired level.
User fee	A payment charged in exchange for a good or service provided by the government.

## **AMENDMENTS**

2010 revision-policy number change from FCS013 to CFO010 due to department reorganization.

PFC2012-16-The key changes from the 2008 policy are the addition of a new economic policy goal for better alignment with Council's Fiscal Plan for Calgary (C2011-65) and The City's Triple Bottom Line (TBL) Policy (LUPP003, EM003, CS003), the revision of the wording for the 9<sup>th</sup> economic policy goal to more closely align with Council's Fiscal Plan for Calgary and The City's TBL Policy, as well as the renumbering of the existing 10<sup>th</sup> and 11<sup>th</sup> policy goals to accommodate the new policy goal.