

Memorandum

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Julia H. Cooper

**SUBJECT: IMPLEMENTATION OF SERVICE
FEES ON CREDIT CARD
PAYMENTS**

DATE: November 30, 2020

Approved



Date

12/2/20

RECOMMENDATION

Adopt a resolution:

- (a) Approving credit card service fees (commonly referred to as convenience fees) on certain eligible transactions as included in the 2020-2021 Adopted Operating Budget and set forth in the staff memorandum to Council; and
- (b) Authorizing the Director of Finance to negotiate and execute an addendum to the existing Merchant Card Services Agreement (as amended) with Wells Fargo Bank, NA for the collection of service fees at rates sufficient to cover all associated fees the City would otherwise pay.

OUTCOME

To implement a service fee as approved in the 2020-2021 Adopted Operating Budget when a customer chooses to make a payment using a credit card/debit card on eligible transactions.

BACKGROUND

The City has fifty-three merchant accounts which accept payments for thirteen City departments. The City pays approximately \$2 million annually in credit card service fees for (i) interchange (charged by two banks involved in a credit transaction – this fee reflects the cost associated with accepting, processing and authorizing the card transaction), (ii) bank fees (fees associated with network gateways and software used to transmit cardholder information and details of transaction to the processing bank), and (iii) discount fee (the fee the City's merchant bank charges the City to act as merchant service provider).

In May 2020 the City sent a survey to municipalities throughout California asking if they charge service fees for credit card transactions. Responses were received from a total of 30 municipalities. From this group there were ten municipalities indicating that they charge service fees or are

planning to implement such a program. The City of San Mateo responded that they were in the process of implementing service fees using the same merchant services provider used by the City. Their implementation was subsequently completed in August 2020.

California Government Code Section 6159 (h) (1) states, in part, that “*a city, county, city and county, or any other public agency may impose a fee for the use of a credit or debit card or electronic funds transfer, not to exceed the costs incurred by the agency or agent in providing for payment by credit or debit card or electronic funds transfer. These costs may include, but shall not be limited to, the payment of fees or discounts as specified...*” This provision of the Government Code provides the City with the ability to pass the cost of accepting credit cards onto the paying customer but creates an important constraint that the amount collected may not exceed the actual cost. The City’s proposed program addresses this constraint.

Proposed Credit Card Service Fee Program Structure

This proposal implements service fees on customers who use credit cards (as well as non-pin debit cards) to make a payment. Service fee programs are available to governments and higher education entities and offer a way to recoup credit card transaction related costs on eligible charges. Eligibility for this program is determined by the merchant category code (“MCC”). MCCs are four-digit numbers that credit card payment brands use to classify merchants and businesses by the type of goods or services provided. Fees with the MCCs of 9311 (tax payments), 9222 (fines), 9399 (government services), and 9211 (court costs) are eligible for this program. Service fees can be imposed regardless of the channel of payment (card present or card not present), applies to all card brands, and must be the only fee to the cardholder. The service fee can be a percent or fixed flat amount.

Wells Fargo Merchant Services (“Bank”), has been servicing City’s credit card payments pursuant to an existing agreement originally approved by Council in 2009 and extended by Council earlier this year. The Bank offers a program for managing the imposition of service fees by local governments. The City benefits by using a third party to the transactions so that no service fees are paid into the City’s accounts. As a result, the City is not required to account for the fees, distribute the monies, or manage fee surpluses to comply with state laws constraining the collection of fees to actual costs incurred. Among all credit card brands, VISA is the only one which must approve the implementation of service fees. The Bank represents the City in the application of this request. The Bank performs a comprehensive evaluation to determine the service fee to charge the customer based on the cost recovery requirements. The evaluation considers the historical fees associated with each eligible merchant account and the expected future volumes and costs. The Bank notifies the City of any changes in fees at least 30 days in advance and City staff reviews changes to fees prior to implementation. At this time, the proposed addendum to the City’s merchant services agreement specifies a service fee of 2.4%. The fee level is subject to change in the future, as described further below.

ANALYSIS

The City accepts credit cards through various methods, including transactions in which the credit card is presented for payment and others in which the payment information is provided without a physical card. To implement service fees on eligible credit card payments, each method for accepting credit card payments must be considered because each method is set up differently.

Online Payments: Most of the online payment platforms used by the City are provided by the Bank using their EBill Express and Cybersource services. These are the easiest to implement service fees since they are the Bank's products. The Bank will make changes to the platforms and add fee disclosure language (provided by the City) to their platform web pages. The Bank will create two new merchant accounts; one for the principal amount and one for the fee. The principal amount will be paid in full to the City's Master bank account. The fees will be paid directly to the Bank, which will use the fees to pay all associated merchant costs.

Non-Bank Gateways: The Library uses a PayPal gateway to process payments using an in-house system. The Library's IT staff is contacting the vendor to determine if the system can accept two merchant accounts. If this can be done at a sufficiently low cost, service fees will be added to these transactions.

Terminals: There are eight merchant accounts that use stand-alone card readers to take credit card payments. The City's current readers cannot be used with the Wells Fargo Service Fee program so they would need to be replaced with an alternate method. One viable solution is to use a virtual terminal through a desktop PC.

Cashiering: The City uses the iNovah cashiering system with Elavon-provided terminals. The terminals can accept two merchant accounts that would accommodate the service fee model but the iNovah system cannot. Additionally, iNovah is not set up to distinguish which payment types to apply fees; an important consideration because the City is not authorized to change service fees to ineligible MCCs. System Innovators, the iNovah cashiering system developer, was asked by the City to develop a solution. System Innovators prepared a work request for \$9,500 that was approved by the Assistant Director of Finance under delegated authority and included in the contract agreement signed on June 12, 2020. Development was completed on September 1, 2020. Configuration changes must be made by the system administrator before the "go live" date.

Customers who do not wish to pay the credit card service fee will have the opportunity to opt out before the completion of online transactions. The following message, or one similar, will pop up onto the screen: *"When submitting a Card payment, you are agreeing to a service fee of 2.40% that will be collected by a third party (Wells Fargo Merchant Services) to cover transaction processing fees. If you do not wish to pay this fee, you may pay using your bank account or make alternative payment arrangements with the City."* As an alternative to credit cards, the customer may still choose to pay online via ACH/echeck for which there is no service fee charged to the City or the customer. The customers also have the option to choose to cancel the online transactions and pay their invoice by paying in person with cash or check or by mailing in a check payment.

Transactions that are voided before settlement is made will also void the associated service fees. When transactions are refunded after settlement, there will not be a refund of service fees as the interchanges and other associated transactions fees will still be charged by the credit card brands and associations,

Agreements: To implement the program, the City would enter a Service Fee Addendum (the “Addendum”) to its existing Merchant Services Agreement (the “Agreement”) previously authorized by Council¹ and executed with the Bank.

The Service Fee: Based on a review of the City’s volume and transactions, the Bank has determined the service fee will be 2.4% of the applicable transaction for both Credit Card and Non-Pin Debit Card charges on platforms and gateways provided by the Bank under the Agreement to accept cardholder payments. If any City departments use a gateway or platform other than the Bank’s, then the Bank cannot administer the fee. The Bank has determined the fee based on anticipated annual volume by card types, average transaction size, credit card organization fees and other pass-through fees. Any changes in these assumptions could cause a change in the cost of the service, and therefore the fee designed to recover the costs. The Bank is required to provide at least 30 days’ notice to the City of any changes in fees, and the City has the right to terminate the agreement based on a change in fees.

The Addendum provides other terms for ending the service fee program. For example, either party may terminate the service fee addendum upon termination of the Merchant Services Agreement, a material breach, where termination is required by a participating card organization, or upon 30 days’ notice. The Bank may also immediately terminate the service if chargebacks to the City exceed 1% in any month. Upon termination of the agreement, the City would pay any remaining fees or expenses related to the program.

Timeline: City staff anticipates a “go-live” for implementation of service fees on March 1, 2021. This date is contingent on completing the iNovah testing in mid-December, VISA approval in mid-January and Cybersource training for staff in February.

After Council approval of the service fee program, the Addendum will be executed by both parties and the Bank will begin implementation. The Bank’s work should take four to six weeks to complete. Following internal City training, the system is expected to go live on March 1.

Affected Merchant Accounts and Fee Savings: Below are the proposed merchant accounts that will have service fees imposed and the estimated full year savings (rounded) from each account. Savings in FY 2020-2021 will reflect implementation in the eighth month of the fiscal year.

¹ Refer to June 16, 2020 Council memo, item 3.6 (file: 20-659) approving extension of the Banking Service Agreements with Wells Fargo Bank at <https://sanjose.legistar.com/LegislationDetail.aspx?ID=4552082&GUID=E4EC5AB4-1756-4BDC-9E1E-77D7D2726592>

Department Activity/Program	MCC Code	Estimated Fees	Point of Sale Method
Finance Treasury	9399	\$22,000	Cybersource
Airport	9399	166,000	Cybersource
Event Services (Public Works)	9399	2,400	Terminal*
San José Police Department (SJPD) Gaming	9399	700	Terminal*
SJPD Permits	9399	3,000	Terminal*
Department of Transportation Parking Permits	9399	9,000	Terminal*
Airport Badging	9399	300	Terminal*
Office of Economic Development (OED)	9399	1,700	Terminal*
Library	9399	1,749	Pay Pal
SJPD Fiscal	9399	3,300	Terminal*
Clerk's Office	9399	400	Terminal*
Cashier (Finance Department)	9399	580,000	iNovah
Online Business Tax	9311	132,000	Ebill Express
Online Fire Permits	9311	17,000	Ebill Express
Online Rev Q (Delinquent Accounts Payables)	9311	23,000	Ebill Express
Online Building Permits	9399	<u>342,000</u>	Cybersource
		\$1,304,549	**

*Payments in these locations are collected by the respective departments.

**2020-2021 Estimates

The chart below represents the merchant accounts not being considered for service fees. Animal Services meets the MCC eligibility, but the recommendation is to not implement service fees for their merchant accounts at this time because their credit card payments vendor cannot accept service fees. This could change if the Animal Services vendor makes appropriate changes to allow the Bank's management program or Animal Services switches to another vendor. The remaining accounts listed are not qualified for service fees due to their ineligible MCC codes.

Department Activity/Program	MCC Code	Estimated Fees	Point of Sale Method
Family Camp	7033	\$5,207	Cybersource
Animal Services	9399	7,981	Terminal ¹
Arcadia Ballpark	7941	450	Terminal ²
Muni Water	4900	695	Terminal
Prusch Park	7523	2,009	Terminal
Happy Hollow Parking	7523	21,458	Ventek
Animal Web License	9399	17,701	Authorize.net ¹
Lake Cunningham Parking	7523	3,405	Ventek
Almaden Lake Parking	7523	1,489	Ventek
Alum Rock Parking	7523	2,055	Ventek
Family Camp Store	7033	435	Terminal
Utilities	4900	245,520	EBill Express
Happy Hollow Spec Events	7996	1,113	Terminal
Happy Hollow Web Sales	7996	4,621	SiriusWare
Happy Hollow Park & Zoo	7996	47,778	SiriusWare
Happy Hollow Food & Bev	7996	19,026	SiriusWare
HHPZ Education	7996	114	SiriusWare
HHPZ Celebration	7996	3,072	SiriusWare
HHPZ Rentals	7996	352	SiriusWare
DOT Parking Garages and Lots ³	7523	<u>312,275</u>	Pmt Express ³
		\$696,753	

Notes:

1. Is not being considered due to restrictions of Authorize.net which is used for Animal Service online payments.
2. Estimated fees as site has not opened yet due to COVID-19 precautions.
3. DOT amounts are paid from DOT – Parking Fund 533.

Program Equity. The Administration has reviewed the service fee program through an equity lens. As a starting point, the program is designed to increase the equitable allocation of costs for using credit and debit cards, by allocating those costs back to the users of the service resulting increased costs for processing payments to the City. For example, significant charges are incurred for building permits, services provided at the Airport, utility charges and other large fees paid to the City. Staff will further analyze the service fee charges following implementation and will report to Council and recommend further adjustments in the service fee charges in upcoming budget processes if staff determines certain users are disproportionately impacted by the service fee charges. Staff is aware that the closure of City Hall makes payment by cash challenging for those without access to credit cards, debit cards and checks and is reviewing measures to accommodate these residents' and business needs. No residents will be required to use credit or

debit cards or to incur such service fees and will always be offered alternative payment options of check, ACH² or cash that do not incur service fee charges.

CONCLUSION

The cost of accepting credit card payments has grown each year as more transactions are paid by credit card and as the merchant fees charged by banks increase. To mitigate the impact of these costs on city services, the 2020-2021 Adopted Operating Budget included the implementation of a service fee to be charged on eligible credit card transactions. Finance Department staff worked with the Bank and System Innovators, the iNovah cashiering system developer, and participating City departments for city-wide implementation of the service fee program.

Implementation has an estimated net impact of reducing the City's Banking Services City-Wide appropriation by approximately \$350,000 in FY 2020-2021, from \$1.71 million to \$1.36 million, and reducing by \$1.3 million ongoing.

EVALUATION AND FOLLOW-UP

This memorandum will not require any follow-up from staff.

CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

PUBLIC OUTREACH

This memorandum will be posted on the City's website for the December 8, 2020 Council agenda.

COORDINATION

This report was coordinated with the City Manager's Budget Office and City Attorney's Office.

COMMISSION RECOMMENDATION/INPUT

This item does not require any input from a board or commission.

² ACH - **Automated Clearing House** (ACH) deposit is an electronic transfer of funds using the Automated Clearing House. The Automated Clearing House is a secure network in the United States through which banks and other financial institutions can transmit electronic transactions. An ACH deposit means that funds are electronically deposited into an account.

COST SUMMARY/IMPLICATIONS

The service fee will vary depending on the changes in cost and volumes. Variations in service fee will be monitored and approved by the City to ensure reasonableness. The recommended action will result in the institution of a service fee of 2.4% of each eligible merchant card transaction for the current fiscal year. The fee percentage may change in the future.

The 2020-2021 Adopted Operated Budget estimated service fee revenues of \$415,000 in 2020-2021 and \$800,000 ongoing. In order to minimize administrative burdens and the risk of the City collecting charges in excess of actual cost in violation of State law, the program recommended in this memorandum proposes instead to have the fees collected by the Bank to offset the charges currently passed on from the Bank to the City. The net effect is an estimated reduction to the City's Banking Services City-Wide appropriation by approximately \$350,000 in 2020-2021, from \$1.71 million to \$1.36 million, and a reduction of \$1.3 million ongoing. Budget adjustments to restructure the program from one where revenue is received directly by the City to one in which the City instead receives a net reduction in costs, will be brought forward during the 2020-2021 Mid-Year Budget Review and monitored throughout the year to determine if future adjustments will be needed. The additional ongoing savings will be incorporated into the 2021-2022 Base Budget development process.

CEQA

Not a Project, File No. PP17-003, Agreement/Contracts (New or Amended) resulting in no physical changes to the environment

/s/

JULIA H. COOPER
Director of Finance

For questions, please contact Nikolai Sklaroff, Deputy Director of Finance, Debt & Treasury Management at (408) 535-7832 or via email at nikolai.sklaroff@sanjoseca.gov.