# Agenda Report

**TO**: CITY COUNCIL **DATE**: JUNE 15, 1998

**FROM**: CITY MANAGER

**SUBJECT**: IMPACT OF LIVABLE WAGE ORDINANCE ON CITY CONTRACTS

RECOMMENDATION

The following is for information only. No City Council action is being requested at this time. To the extent, however, that additional budget appropriations are necessary to absorb increased contract costs arising from the adoption of a Livable Wage ordinance, staff will return to City Council with appropriate recommendations.

BACKGROUND

On June 8, 1998, the City Council directed the City Attorney to draft a "Livable Wage" ordinance. The ordinance will require firms receiving city labor or services contracts, in excess of $25,000, to pay their employees assigned to the contract no less than $7.25 per hour with medical benefits or $8.50 per hour without benefits.

Last June, staff estimated that a "Livable Wage" ordinance of the type described above would cost the City and additional $340,000 per year in increased contract costs. In order to provide City Council with the most accurate projections available, staff has reconsidered this analysis.

One of the studies compiled for the City of Los Angeles prior to the adoption of its "living wage" ordinance found that most low-wage contract employees were concentrated in service-type jobs including, landscaping, parking, janitorial, security and general labor. Staff's research, which included a survey sent earlier this calendar year to over twenty-five (25) contractors, indicates Pasadena's experience to be no different. At any given time, there are between six (6) and twelve (12) city contracts that are in excess of $25,000 and involve the type of contract workers that earn less than the specified "livable wage". Attachment "A" is a current list of these contracts.

It is staff's position that the City will ultimately bear the increased cost associated with requiring contractors to pay "livable wage". This position was outlined in a memorandum to City Council on July 8, 1997 (copy attached). Staff estimates that the application of "livable wage" to those contracts listed in Attachment "A" would cost the

City approximately $326,000 annually. It should be noted that this estimate does not include contracts issued by the Rose Bowl Operating Company or the Pasadena Center Operating Company. In the event the City waits until current contracts are up for renewal or re-bid to impose the livable wage requirement, as suggested in the Mayor's report on June 8, the estimated cost in fiscal year 1998-99 would be reduced to $168,000. Of this amount $40,000 would be charged to the Water Fund for its Landscaping contract and $10,000 would be charged to the Power Fund for its Tree Trimming contract. In addition, portions of the remaining $118,000 are for services provided City-wide. As such, it appears that the direct impact on the General Fund for fiscal year 1998-99 will be less than $100,000.

In an effort to offset the initial costs even further, the Mayor has suggested making extension of any existing contract subject to "livable wage" contingent upon the contractor absorbing all or some of the additional labor expense. This month two of the contracts listed in Attachment "A" will be up for possible extension and another five will be up in fiscal year 1998-99. To the extent that some of these contractors are willing to absorb costs, the $168,000 figure above would be reduced.

FISCAL IMPACT

The estimated maximum fiscal impact of applying "livable wage" to the contracts listed in Attachment "A" is $326,000. Applying "livable wage" to contracts as they come up for renewal or re-bid is expected to cost the City $168,000 in fiscal year 1998-99.

Respectfully submitted,

for Cynthia J. Kurtz
Acting City Manager

Approved by:

Jay M. Goldstone for
Director of Finance

Prepared by:

Steven B. Mermell
Purchasing Administrator

Attachment "A"
Contracts For Labor Or Services That Involve Persons Not Making "Livable Wage"

| | |
|---|---|
| Contract # | 16,386 |
| Contractor | Davey Tree Surgery |
| Description | Utility Tree Trimming |
| Date Awarded | 6/9/97 |
| Expiration Date | 7/22/98 |
| Extension or Re-bid | Two one-year optional extensions. |
| Contract Amount | $350,000 per year |

| | |
|---|---|
| Contract # | 16,475 |
| Contractor | Golden Bear Arborists |
| Description | Pruning of Street Trees |
| Date Awarded | 9/8/97 |
| Expiration Date | 10/28/98 |
| Extension or Re-bid | Two one-year optional extensions |
| Contract Amount | $115,000 per year |

| | |
|---|---|
| Contract # | 16,544 |
| Contractor | Natural Building Maintenance (NBM) |
| Description | City-wide Housekeep Services |
| Date Awarded | 12/15/97 |
| Expiration Date | 12/15/00 |
| Extension or Re-bid | One three-year optional extensions |
| Contract Amount | $412,000-1st year $469,000-2nd year $525,000-3rd year |

| | |
|---|---|
| Contract # | 16,559 |
| Contractor | L. Barrios & Associates |
| Description | Landscape Maintenance |
| Date Awarded | 1/13/98 |
| Expiration Date | 1/13/99 |
| Extension or Re-bid | Two one-year optional extensions |
| Contract Amount | $74,000 per year |

| | |
|---|---|
| Contract # | 15,743 |
| Contractor | Inter-con Security |
| Description | Security at Various City Locations |
| Date Awarded | 6/6/95 |
| Expiration Date | 6/6/98 |
| Extension or Re-bid | Two one-year optional extensions. |
| Contract Amount | $410,000 per year |

| | |
|---|---|
| Contract # | 15,707 |
| Contractor | Systems Management Inc., |
| Description | Lawn, Shrub and Tree Maintenance for the Water Division |
| Date Awarded | 5/1/95 |
| Expiration Date | 8/11/97 |
| Extension or Re-bid | To be re-bid in June/July '98 |
| Contract Amount | $250,000 per year |

| | |
|---|---|
| Contract # | 16,005 |
| Contractor | Ampco Parking Systems |
| Description | Operation of City Parking Garages |
| Date Awarded | 6/17/96 |
| Expiration Date | 6/27/99 |
| Extension or Re-bid | Two one-year optional extensions |
| Contract Amount | $553,888 per year |

| | |
|---|---|
| Contract # | 16,417 |
| Contractor | Harnisch Tree Care |
| Description | Palm Tree Pruning |
| Date Awarded | 7/14/97 |
| Expiration Date | 7/14/98 |
| Extension or Re-bid | Two one-year optional extensions |
| Contract Amount | $70,000 per year |

| | |
|---|---|
| Contract # | 16,401 |
| Contractor | Golden Bear Arborists |
| Description | Tree Removal |
| Date Awarded | 6/27/97 |
| Expiration Date | 6/27/98 |
| Extension or Re-bid | Two one-year optional extensions |
| Contract Amount | $60,000 per year |

# MEMORANDUM

## CITY OF PASADENA

**DATE:** July 8, 1997

**TO:** City Council

**FROM:** City Manager

**SUBJECT:** Living Wage

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The attached has been prepared as part of the continuing analysis of "living wage". Copies have been provided to members of the Living Wage Coalition as well as the Chamber of Commerce. It is hoped that this information will facilitate discussion of the issue at the July 21st City Council meeting.

# M E M O R A N D U M

## CITY OF PASADENA

### Department of Finance

**DATE**: July 7, 1997

**TO**: Jane Hinshaw, City Manager's Office
**CC**: Jay Goldstone, Department of Finance

**FROM**: Steve Mermell, Department of Finance

**SUBJECT**: Living Wage and Contract Costs

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**EXECUTIVE SUMMARY**
A careful review of the analysis prepared by UCLA, UC-Riverside and the Los Angeles Chief Legislative Analyst/City Administrative Officer indicate that were the City of Pasadena to adopt a living wage program the associated additional contract costs would ultimately be borne by the City.


**I. BACKGROUND**
The agenda report submitted to City Council on June 23, regarding the potential impacts of "living wage" assumed that increased costs associated with City service contracts would ultimately be passed on to the City. Staff conservatively placed these costs at between $330,000 to $780,000 per year, excluding the cost of program administration. Conversely, representatives of the Living Wage Coalition have put forth the proposition that contractors will absorb these costs by reducing their profit margins thus, resulting in no additional cost to the City. Going one step further, the attorney responsible for drafting the Coalition's proposal states that a living wage program would actually result in a net cost savings to the City, "[I]t is unlikely that the Living Wage Ordinance would actually increase the cost of a particular service contract. Studies show that such concern is unwarranted since the higher labor cost would be absorbed by the contractors from their profit margins and not passed onto the City. There would also be savings to the contractors from the decreased worker turnover. Furthermore any possible extra immediate cost would be outweighed by the savings to the City achieved by the decrease in the use of City social services by the higher-paid workers."

Whether or not to adopt a living wage ordinance is the type of policy issue which can properly be decided only at the City Council level. In an effort to provide the City Council the most accurate information with which to make that decision, the following reexamines the question of who will incur the additional contract costs associated with living wage. In so doing the review will consider the following studies:

- An Empirical Analysis of the Proposed Los Angeles Living Wage Ordinance, Dr. Douglas Williams, Assistant Professor of Economics, Carleton College and Dr. Richard H. Sander, Professor of Law, UCLA (referred to herein as the UCLA study)

- Economic Analysis of the Los Angeles Living Wage Ordinance, Project Director: Professor Robert Pollin, Department of Economics, University of California-Riverside (referred to herein as the Riverside study)

- Analysis of the UCLA Fair Housing Institute Study of the Proposed Living Wage Ordinance, an interdepartmental correspondence prepared by Ronald F. Deaton, Chief Legislative Analyst and Keith Comrie, City Administrative Officer City of Los Angeles (referred to herein as the LA CLA/CAO study)

It should be acknowledged that in the spirit of cooperation the UC Riverside and the LA CLA/CAO studies were provided to staff by the Living Wage Coalition. The Coalition also provided information from a study prepared by The Preamble Center for Public Policy regarding the City of Baltimore's living wage program; however, as it was only summary information it was not of value for this analysis. Nonetheless, Baltimore's program is discussed in this report.

## II. THE UCLA STUDY

On balance, the UCLA study concludes that costs associated with the service contractor component of the Los Angeles living wage program will be passed on to that city. The report summary states:

"The total cost of the Ordinance to service contractors thus represents about 4-7% of the total amount of all City service contracts..." "These costs could be covered in one of three ways:

- The City could decide to absorb the cost, and find higher revenues or offsetting spending reductions to pay for it. If the City did absorb the cost, the increase in City expenses would take several years to be fully felt, since many of the contracts are for several years and only new contracts are covered.

- The City could make case-by-case judgments about the ability of contractors to absorb the cost, increasing contract amounts where it concluded that the firm could not absorb the cost. We have seen no evidence on the question of whether City service contractors have, in some cases, above-average profit margins that would make it possible for them to absorb the higher costs. Even if such profits existed, however, the City will have difficulty making contractors absorb costs in the absence of changes in methods of awarding contracts.

- The City could allow the coverage of the new expense to be worked out by individual contracting department. We predict that under this policy, the cost will eventually be borne by the City in the form of higher contracting costs (when departments are able to secure higher appropriations) or lower services."

## III. THE LOS ANGELES CLA/CAO STUDY

After careful review of the UCLA study as well as performing some independent analysis, the LA CLA/CAO concluded, "[b]ased on our review, we find UCLA's data and study methodology to be sound and their estimates reasonable." "Our review of the City's service contractors leads us to believe that, in most cases, the City would, in the long run, pay the increased cost of these services in order to maintain existing service levels. The City, for example, requires a certain level of security services for its various facilities and must meet this need -- even at additional cost. There may be cases where service contract cost increases for such services as tree-trimming may cause the City to reexamine its service needs, possibly resulting in reduced customer services."

## IV. THE RIVERSIDE STUDY

In contrast to the UCLA and LA CLA/CAO studies, the Riverside study indicates that despite a total estimated cost of over $93 million that "the [City of Los Angeles] living wage ordinance can be implemented while causing no net increase in the City budget, no employment loss and no loss of City services to the residents of Los Angeles." In support of this finding the Riverside study cites the experience of San Jose, California's prevailing wage program, Baltimore, Maryland's living wage ordinance as well as the ability of City of Los Angeles service contractors to absorb increased costs of operation.

### A. San Jose's Prevailing Wage Regulation And Its Impact

In 1988 the City Council of San Jose, California, formalized that city's practice of applying prevailing wage requirements on city-funded public works construction projects. In the following year, the Council extended the scope of the policy to include certain service contracts. Under the extended program, city contractors and their sub-contractors are required to pay the general prevailing wage, as established by the state Department of Industrial Relations, to all workers involved in the following city contracts:

- City public works construction projects funded in whole or in part by city funds.
- City maintenance contracts in excess of $1,000 which involve grounds and structures.
- Direct Services in the areas of residential street sweeping, convention center food services, parking lot management services, and janitorial or custodial services.

The Riverside study concluded that this program has not generated any significant cost for the City of San Jose. However, on further review this conclusion may lack complete support. The study is based on informal assessments done by city staff and the study's authors admit "[w]e were unfortunately unable to obtain systematic data on contracting patterns, since we could not obtain records for a sufficiently long time period before the 1989 resolutions took effect." Further, "the city has been unable to estimate the costs of routine maintenance contracts, because, it explains, contract requirements vary from year to year and market wage data for the numerous maintenance classifications was not readily obtainable." And, "[w]ithout full coverage of service contracts and with no estimate of the costs of routine service contracts, it is difficult to get a good overall figure for the direct contract costs resulting from the prevailing wage requirements."

Nonetheless, the city and the study's authors estimate that the prevailing wage program costs San Jose approximately $2.8 million per year. Because this $2.8 million figure represents less than 1% of the total annual budget for San Jose, the authors conclude the program's costs to be non-significant.

Similarly, staff has preliminarily estimated the potential impact of a living wage program in Pasadena at between $1.5 and $2.7 million annually. The City's total budget for fiscal year 1997-98 is approximately $350 million; therefore, a living wage program would also represent less than

1% (0.43 to 0.77 percent to be exact) of the City's annual budget.

While presenting costs in this fashion make them appear less significant, the reality is that only a about a third of the City's overall budget is discretionary i.e., available for reduction, and that identifying up to $2.7 million in the current and subsequent budgets to fund a living wage program would need to be accomplished through corresponding cuts.

## B. Baltimore's Living Wage Ordinance And Its Impact

The City of Baltimore's living wage ordinance went into effect in July 1995. The ordinance requires that employees of city service contractors be paid a "prevailing minimum hourly wage rate." In July 1996, the wage was $6.10 per hour. The wage was increased to $6.60 per hour in January 1997, and as of July 1, 1997 the wage is $7.10 per hour.

The Riverside study-team found no increase in costs to the City of Baltimore after the program's first year. Interestingly, actual contract costs decreased over the one-year study period; however, the authors admit, "[w]e cannot, of course, conclude that the living wage ordinance actually contributed to lowering the cost of the average contract."

As with San Jose, Baltimore's experience and the analysis used to interpret it must be viewed carefully for applicability to Pasadena. The prevailing minimum wage under the Baltimore program has been fairly modest as compared to the hourly rates established by the Los Angeles ordinance and that proposed by the Living Wage Coalition. Further, Baltimore does not require the provision of employer paid medical benefits.

Additionally, the LA CLA/CAO study and especially the UCLA study raise questions about the Riverside study's Baltimore findings. The LA CLA/CAO study included the following:

> "Baltimore's Chief Purchasing Agent notes, however, that the 1997 increase in the City's living wage to $7.10/hour [July 1, 1997] were a major cause in a significant increase in the most recent bids received for custodial services at 9 schools. The bids on those 5-year contracts came in $30,000-$40,000 per school higher than the previous 5-year contracts. This equates roughly to a $2.7 million increase in $9 million worth of contracts. There were no material changes in the job specifications between the two time periods. While some of these increased costs can be attributed to cost-of-living increases, the City's Chief Purchasing Agent determined that most of the cost increase can be attributed directly to the wage requirements of the city's living wage ordinance. The funding agency for these services (the US Department of Education) has declined to pay the increased costs. The City, meanwhile, is planning to rebid those contracts and is currently reviewing the bid specifications to determine how to reduce the cost of each contract by reducing personnel or service requirements."

The UCLA study commented, "[w]e think that the Baltimore study is an example of the kind of primary research that should be used to determine the effects of policies like living wage ordinances, and we think their findings are sufficiently intriguing for pause. Still we do not think they are sufficiently strong to rebut a presumption that employment will decline and city contracting costs will increase because of the [Los Angeles] ordinance. In several respects, as the authors acknowledge, their data is incomplete mostly, it seems, because of unavailability of much data at the time of their study. They had no information on how many workers actually received higher wages as a result of the ordinance (thought they said the number was "fairly small"). And thus had no estimate on the total cost increase that needed to be absorbed. Some of the contracts declined sharply in price, suggesting that there may have been changes in the composition of services provided by contract. And 80% of the total contract value covered by the study was accounted for by a single contract (for school bus services)."

## C. The Ability Of City Service Contractors To Absorb Increased Costs

Finally, the Riverside study concluded that in the City of Los Angeles there are 849 firms which would be affected by that city's living wage ordinance. And, that the total direct cost of the program would be $39.4 million. The authors determined the total output of the 849 firms to be $3.9 billion, thus, using similar logic to that applied to the San Jose program, they concluded the cost of the living wage program to be less than 1% of total output; a sum easily absorbed by affected contractors.

As mentioned previously, dividing the costs of a given program by an agency's total budget or total output distorts the true level of costs. It is also worth noting that the Riverside study included the following qualification:

> "Of course, some firms will incur substantial increases in costs...the City should be prepared to permit these firms to pass through most of their increased costs, either through changes in their contract terms or, in the case of concessionaires, through small increases in the prices they charge to consumers."

As mentioned at the outset of this report, proponents of living wage have suggested that contractors will benefit through increased worker productivity and that any possible extra immediate cost would be outweighed by the savings to the City achieved by the decrease in the use of City social services by the higher-paid workers. The following two sections consider these points.

# V. POTENTIAL SAVINGS THROUGH PRODUCTIVITY-DIVIDEND

The Riverside study included an analysis of what it termed the "productivity-dividend". The study constructed several theoretical scenarios under which contractors could absorb some or all the cost of a living wage program as a result of natural growth in productivity. Likewise, the UCLA study acknowledges that higher pay is likely to lead to more productive workers. However, there are several issues concerning this "productivity-dividend". First, in order to avoid pass-throughs to the contracting agency the growth in productivity must be equal to the total additional costs incurred as a result of the living wage program. The Riverside study appears to acknowledge the unlikeness of this by constructing a model which actually passes 2/3 of all direct increased costs to the City of Los Angeles which is then expected to make offsetting internal reductions. Additionally, Riverside's "productivity-dividend" theory relies heavily on contractors making permanent reductions in their workforce and using the savings to pay higher wages.

The UCLA study is more circumspect in its consideration of the "productivity-dividend". In regards to the issue the authors write, "higher pay is likely to lead to more productive workers.

The critical question is how large this effect will be. Unfortunately, very little is known about this issue. There has been much interest by labor economists in "efficiency wage" theory -- the notion that higher wages lead to greater effort by workers and higher productivity -- but no empirical research showing that firms that could benefit from higher wages are not, in fact, paying such wages. The lack of research is partly due to the rarity of scenarios in which a large exogenous wage increase is suddenly given to a large group of workers."

## VI. POTENTIAL SAVINGS BY DECREASED USE OF CITY SOCIAL SERVICES

Another argument put forward by proponents of living wage is that any costs to the City will be offset by savings achieved through a reduction in the use of social services by affected workers.

The Riverside study examined the savings to government which would be expected to be achieved through the implementation of the living wage program in the City of Los Angeles. The savings totaled an estimated $33.3 million and breakdown as follows:

| | |
|---|---|
| *SAVINGS TO THE FEDERAL GOVERNMENT* | |
| Higher Income Tax Revenue | $ 5.5 million |
| Less Earned Income Tax Credit payments | $ 8.0 million |
| Less Food Stamp Payments | $11.2 million |
| Less MediCAL Coverage | $ 2.9 million |
| *SAVINGS TO STATE GOVERNMENT* | |
| Less MediCAL Coverage | $ 2.9 million |
| *SAVINGS TO LOS ANGELES COUNTY* | |
| Less Indigent Health Coverage | $ 2.8 million |
| ***TOTAL*** | **$33.3 million** |

As the above figures reveal, over ninety-percent (90%) of the anticipated savings accrue to the benefit of the federal and state government. An argument could be made that if a local government which institutes a living wage program ultimately pays its costs, that it is, in effect, providing a subsidy to the state and federal government.

Generally speaking, it is the County of Los Angeles and not the City of Pasadena which is the provider of last resort for local residents, except, perhaps in the provision of medical care, since the City maintains its own Community Health Center. While it is conceivable that the employees of city service contractors who would be provided medical insurance under a living wage program would not need the services of the Health Center, thus saving the City money, there has been no research to determine whether any such persons are currently using these services and whether such use comes at a cost to the City. Moreover, the agenda report presented to City Council on June 23, pointed out that the majority of persons employed by City service contractors do not reside within the City of Pasadena.

## VII. CONCLUSION

The UCLA and the LA CLA/CAO studies support the notion that the City will ultimately pay the increased contract costs associated with a living wage program. The Riverside study acknowledges that San Jose's prevailing wage program costs that city $2.8 million per year; that the City of Los Angeles should be prepared to accept cost pass-throughs by affected contractors and, that the reduction in social services through a living wage program would accrue to the benefit of the state and federal government and not the local jurisdiction. Likewise, as mentioned in the June 23, agenda report, the City's only experience in the area of living wage, providing higher wages and benefits to housekeeping contract workers, resulted in additional cost to the City. Further experience indicates that when City projects include prevailing wage requirements, as a result of the presence of federal/state funds, contract costs greatly exceed that which would otherwise be available in the marketplace. Given all this, staff can only conclude that were the City to adopt a living wage program it would bear the additional contact costs.

It should be noted that while much of the discussion concerning living wage has been devoted to City service contracts, the Living Wage Coalition's proposal involves a far greater scope of coverage including, amongst other things, the City's internal workforce, General Relief Workfare participants and City affiliated agencies. Based on staff's preliminary assessments, increased City contract costs represent only about 28% (approximately $781,582) of the anticipated overall cost of the Living Wage Coalition's proposal (approximately $2.7 million). With the possible exception of increased costs to the Rose Bowl Operating Company of approximately $374,267 to $554,732, there has been no suggestion, nor could there be argument that the costs associated with the City's internal workforce, administrative overhead and the potential conversion of 40,000 Workfare hours to City staff time or contractor hours would be borne by anyone other than the City. Under the Coalition's proposal these costs total approximately $1.4 million.