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Building community value with prevailing wage

The Value of Linking Good Construction Jobs to California's Housing Reforms

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ABOUT THE AUTHOR

ALEX LANTSBERG, MCP, AICP is a Research Analyst with Smart Cities Prevail, a leading construction industry research and education organization. Alex holds a Master of City Planning from the University of California, Berkeley and a Bachelor of Science in Finance from Northern Illinois University. He was admitted to the American Institute of City Planning in 2013. Having completed the advanced training program in IMPLAN, the leading economic impact software, Lantsberg has coauthored numerous economic impact studies, including research analyzing the economic impact of prevailing wage laws in California and across the country, the public costs of wage and benefit restructuring, and the economic impact of minimum wage. Lantsberg has also conducted considerable research around sustainable urban energy, water, and wastewater infrastructure planning.

Introduction

The cost of California housing and the level of most working Californians' wages are dangerously misaligned. The State of California has identified housing development as a key ingredient in pursuing broad equity, sustainability, and economic goals. But what is to be done about wages?

Several proposed frameworks to reform California's residential development process now are coming into focus. Leading legislators are offering the opportunity to connect the supply-side approach to the jobs-housing mismatch to a construction industry labor standard —“prevailing wage”— that buttresses good career opportunities through middle-class compensation and best-in-class vocational training.

Prevailing wages and apprenticeships also could help address a looming issue: The housing industry may have difficulty finding workers in sufficient numbers and with the requisite skills to build the housing it needs. Despite the fact that construction employment has only recovered to levels seen in 2000, unemployment rates are relatively low. Housing development at the scale envisioned by state policy makers will entail a jump in demand for construction labor that likely will outstrip supply unless industry wages and benefits improve.

The California residential building industry has for decades been on the path of declining wages, the evaporation of health and retirement plans, little systematic skills training, and reduced productivity. Quite simply, it takes 13% more workers today to produce the same amount of output than it did 20 years ago.¹ With immigration unlikely to expand any time soon, a productivity renaissance will be necessary to produce housing units in the numbers that will noticeably shave what Californians pay for housing.

With low wages and lower-than-average benefits coverage, the housing industry does not fully “internalize” the costs of its activities, either shifting those responsibilities on to the public or leaving significant social needs unmet. Because construction labor accounts for only 15% of housing development costs, the benefits of incentivizing a “high-road” workforce strategy in a comprehensive reform package will dramatically outweigh the minimal impacts of wage standards on total project development costs.

**CONSTRUCTION
LABOR ACCOUNTS FOR
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DEVELOPMENT COSTS.**

The value of prevailing wage

In its 2014 study, *Building the Golden State, Smart Cities Prevail* examined the impacts of prevailing wages on California's construction industry.

Our findings mirrored the overwhelming research consensus that prevailing wages do not increase overall project costs, but do result in stronger local economies, more local hiring, and less reliance on taxpayer-funded public assistance by construction workers. Employers respond to higher direct wages by improving the skills of their workforce offsetting higher per-unit labor costs with higher worksite productivity and less spending on such things as fuels and materials.

Reduced reliance on public subsidies: We estimate that if California's multifamily residential construction resembled the rest of the industry on wage standards, worker income would increase by more than \$1 billion, state and local government coffers would grow by \$55 million a year, and public assistance payments for direct expenditures like MediCal would decrease by at least \$30 million per year.²

Additionally, raising incomes for residential construction workers through a prevailing wage policy would improve housing affordability for the thousands of working families that are already far more likely to qualify for already inadequate housing subsidies than the workforce at large. Because of the disproportionate

concentration of workers of color at the lower end of the construction industry wage distribution, as discussed below, communities on the margins of economic growth would be among the greatest beneficiaries of a higher wage standard.

Local workforce development: Apprenticeship is a regulated, earn-while-you-learn, multi-year training system that includes a clear wage ladder for career advancement that is tied to the acquisition of skills and experience. Research shows that apprenticeships not only substantially raise the lifetime earnings of its

participants, but provide significant net social benefits through higher tax collections, private health care coverage, and reduced reliance on unemployment insurance and other forms of assistance. In fact the increased lifetime earnings for workers

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completing their apprenticeship are roughly equivalent to the costs of subsidizing an affordable, below-market rate residential unit.³

California's construction apprenticeship system is among the state's largest post high-school educational systems, with more than 35,000 participants receiving a combination of classroom and on-the-job training. Prevailing wage regulations are one of the underlying pillars of California's construction apprenticeship system, relying on state certified, privately run apprenticeship programs funded by employer contributions from public works and private union jobs. Union-affiliated joint Labor-Management administered apprenticeship programs account for approximately 95% of the state's registered construction apprentices.

Improving industry productivity: Industry associations like the Associated General Contractors⁴ and analysts like McKinsey⁵ have identified labor productivity as a key to the industry's growth and its ability to efficiently and cost-effectively ramp up residential production in California. While a perennial concern in years past, this problem may prove all the more difficult to address at times of growing infrastructure investment, when the best skilled workers are drawn to the higher compensation levels of public works construction.

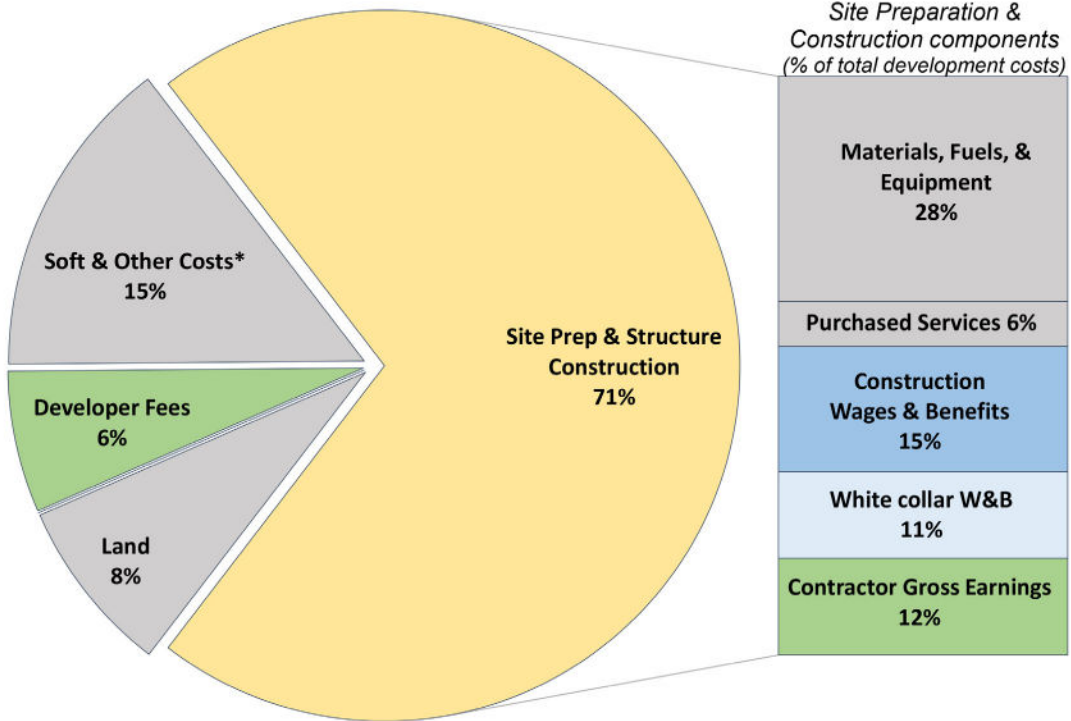
Apprenticeship programs accept, each year, only as many trainees as are needed to meet projected demand for their labor. As a demand-driven training program, apprenticeship avoids the pitfalls often associated with workforce development: training more people than there are jobs. Policies that encourage more construction projects to utilize state-registered apprentices will create more openings for workers who can obtain middle-class careers in the industry.

RESEARCH SHOWS THAT APPRENTICESHIPS NOT ONLY SUBSTANTIALLY RAISE THE LIFETIME EARNINGS OF ITS PARTICIPANTS, BUT PROVIDE SIGNIFICANT NET SOCIAL BENEFITS.

Construction Labor and Multi-Family Housing Development

Given that construction labor comprises only 15% of total California housing development costs, it is unlikely that elevated wage standards could have major impacts on total housing costs. The preponderance of academic research on prevailing wage standards⁶ cost impacts has found no significant overall impacts on the construction of nonresidential structures.⁷

State government housing officials were motivated to commission a study of tax credit assisted developments of below market rate housing by a suspicion that specific regulatory choices created significantly higher costs. Several regulatory programs or requirements were prime suspects: California’s Redevelopment Area program and accompanying regulations; federal and/or state mandates that projects deemed to be public works require payment of “prevailing wages” to construction workers; California Environmental Quality Act (CEQA) review and mitigation; and tax credit regulations that connect higher project application scoring to various project and/or site amenities. Statistical analysis of nearly 300 California housing projects found that none of these factors proved to exercise powerful influence on housing costs.



Sources: U.S. Census (2007 & 2012), *Economic Census*, Table EC1223A1; State of California (2014), Affordable Housing Cost Study
 * Architecture & engineering, surveys, permit & impact fees, offsite improvements, site acquisition, & misc. other costs
 Note: Total Site Preparation, Demolition, & Structure construction and the sum of its individual components do not equal due to rounding.

Misconceptions about construction labor are prevalent in the public debate regarding the costs of residential development. The pie chart on the previous page presents the cost structure of California multi-family housing development. It is derived from two highly credible sources: the State of California’s *2014 Affordable Housing Cost Study*⁸ (AHCS) and *Economic Census data* specific to California’s construction industry.⁹ While this is a snapshot of the residential building industry, changes over the past generation show a clear divergence between the costs of construction and distribution of the value it generates. Since 1992 the construction industry’s gross operating surplus, the basis for profitability, has increased 50% more than either materials or construction labor, according to the Economic Census.¹⁰

Using this data we find:

- The largest cost components, comprising 34% of total project costs, are the **materials, fuels, equipment, and purchased services** required to build the structure.
- **Contractor earnings and developer fees**¹¹ together account for at least 18% of a project’s total costs. Because developer fees are capped by the regulations of the California Tax Credit Allocation Committee, the source of the project cost data, it is reasonable to expect developers of market rate projects to demand higher fees.
- **Soft & other costs**, which includes architectural & engineering services, acquisition & finance costs, off-site improvements, and permitting and impact fees comprise another 15% of total project costs.
- **Construction wages and benefits** average approximately 15% of total project costs, just under 22% of the total “hard cost” of the structure. This includes demolition and site preparation expenses, which are broken out separately from building costs in the AHCS.
- **White collar wages & benefits** account for 11% of project costs. White collar workers comprise approximately 30% of the construction industry’s employees but account for more than 40% of its payroll.
- **Land**, on average, accounts for 8% of a below-market rate project’s costs according to the AHCS¹², however this is among the most variable of expenses. High demand coastal markets routinely see much higher land cost shares for both affordable housing and market rate projects.

Analysis of the AHSC data reveals three fundamental factors — location, the business cycle and project type and scale — are the most important drivers of variation of BMR housing costs. Indicators of these three fundamental forces can account for 85 percent of the variation in affordable housing total development costs (net land acquisition costs). When various regulatory requirements, developer characteristics, or project level details are added to the model, those hypothetical “cost drivers” only marginally improve the model’s overall fit with the data. Regulatory impediments, which are the principal target of proposed reforms, were found to have a statistically significant impact of approximately 8% on costs. Prevailing wages on the other hand only showed an impact of about half that, albeit that impact was not found to be statistically significant.

Given the evidence above, it is clear that (1) construction labor costs are far from the determining factor in overall housing costs and (2) the industry has room to absorb wage increases for the men and women building the housing California desperately needs.

IT IS CLEAR THAT THE INDUSTRY HAS ROOM TO ABSORB WAGE INCREASES FOR THE MEN AND WOMEN BUILDING THE HOUSING CALIFORNIA DESPERATELY NEEDS.

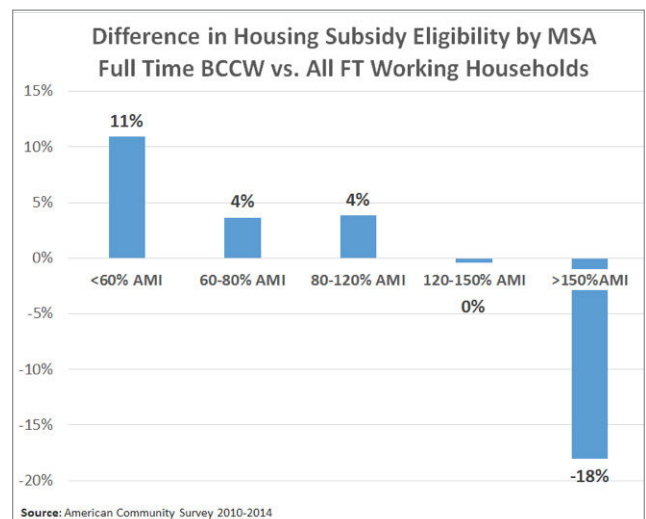
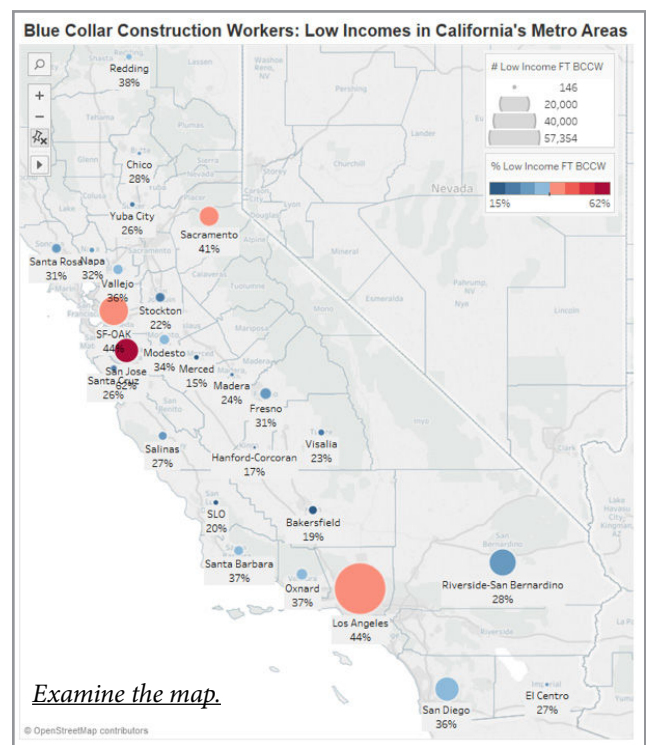
The Housing Affordability and Social Challenges of California's Residential Construction Workforce

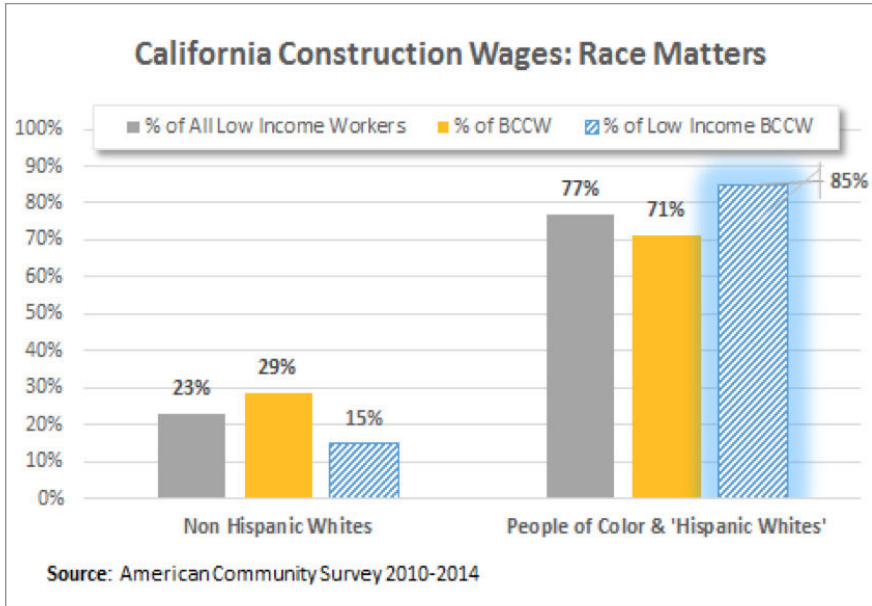
The Legislative Analyst's [California's High Housing Costs: Causes and Consequences](#) explicitly lays the blame for the state's unaffordability crisis on inadequate housing production. While the problem is most acute in coastal regions, high housing cost burdens exist in every part of the state.

Price relief through “filtering” of increased housing supply will take time however. In the meantime, nearly 40% of California blue collar construction workers (BCCWs) are low-income workers earning less than two-thirds the area median income. Today, the statewide median annual wage for a BCCW is approximately \$35,000, with that median sinking to \$30,000 in Los Angeles County, according to U.S. Census Bureau survey data.¹³

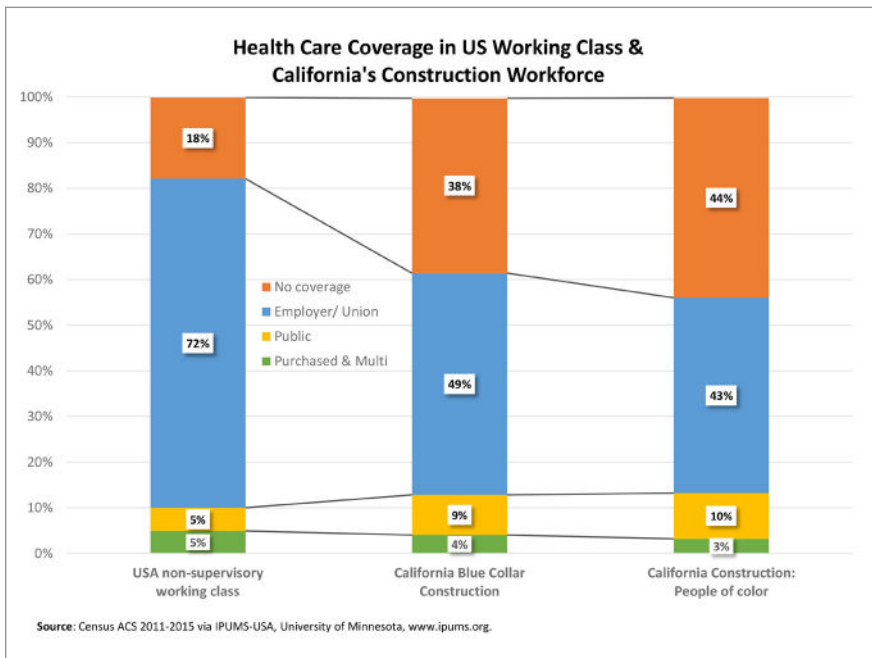
Housing affordability is a problem for BCCWs throughout the state. While only about 25% of statewide households with a full time worker qualify for tax credit based low-income housing subsidies (under 60% AMI) or inclusionary units (between 60% & 80% AMI), that figure rises to 40% for full-time BCCW households. In the five largest metros, containing about four-fifths of California's population, that proportion rises to 42%. In the state's two wealthiest metros – San Jose and San Francisco – 55% and 48%, respectively, of BCCW households qualify for housing subsidies.

Race is both a defining characteristic of the blue collar construction workforce and a dividing line for workers' well-being. Statewide, non-whites make up more than seventy percent of BCCWs and comprise 85 percent of the low-



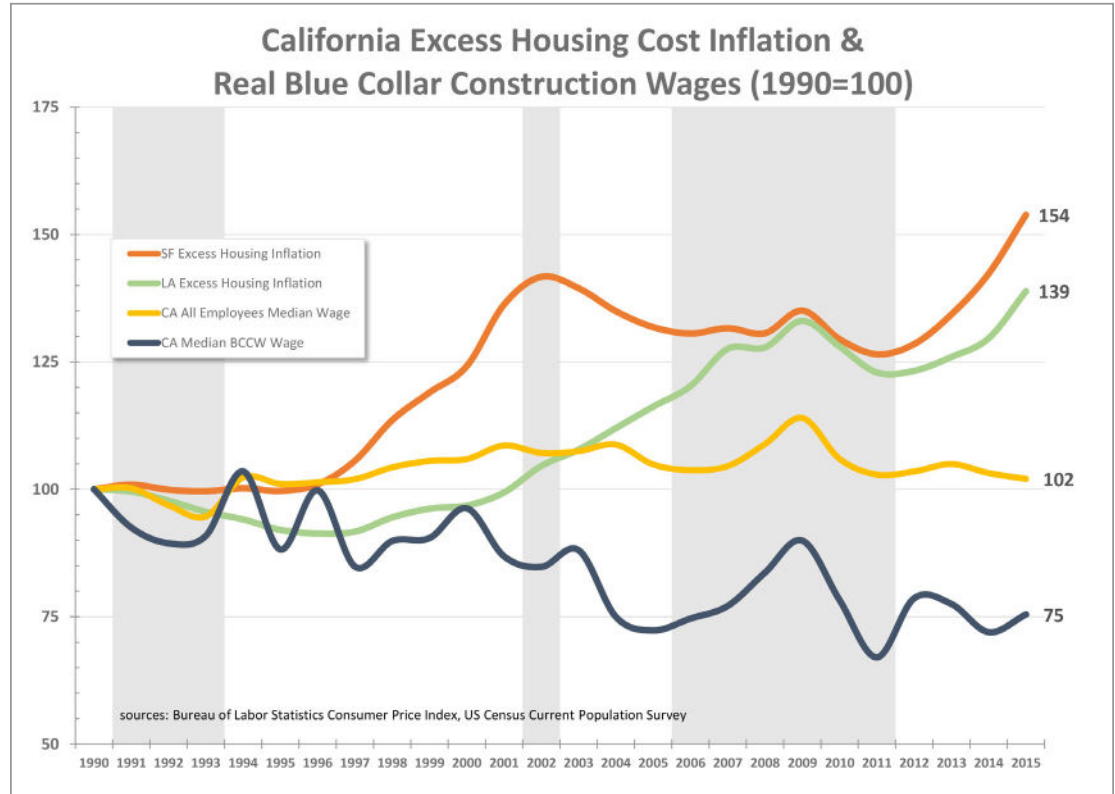


wage construction workers. Latinos, who make up two-thirds of California BCCWs, saw annual wage income of slightly less than two-thirds of that of white BCCWs (\$35,800 vs \$55,300). Controlling for skill, lesser-skilled Latinos make about \$0.70 on the dollar compared to lesser-skill Whites; more-skilled Latinos make \$0.68 on the dollar compared to more-skilled whites. There are similar disparities for other non-white BCCWs.



The construction industry's steadily declining wages and growing reliance on the public to subsidize its workforce's basic living needs is also evident in health coverage data. According to Census data 38% of blue collar construction workers have no health care coverage, even after implementation of the Affordable Care Act. Consistent with the racialized character of the industry's low wage

workforce this number rises to 43% for BCCWs of color. These are more than twice the national average for lack of health care coverage for non-supervisory production workers. Use of Medicaid is 1.8, and 2.2 times the national average respectively. A growing low wage residential construction workforce combined with the threatened disruption of the health care marketplace have the potential to further



swell the ranks of the uncovered when California can least afford to subsidize profitable industries meeting basic needs.

Union apprenticeships and membership substantially elevate wages of Hispanics and African Americans. Union membership is associated with greater Latino wage gains than those associated with a high school degree, citizenship, or a more skilled construction occupation.¹⁴ Over 80% of apprentices enrolled in the Carpenters Training Center for Northern California are people of color.

Trends over the past generation suggest that markets will not take care of a dramatically widened gap between BCCW wages and California housing costs. Since 1990, “real” (inflation-adjusted) BCCW wages have declined almost 25%. Inflation-adjusted housing costs have gone up between 39% in the LA Region and 54% in the Bay Area, far exceeding the rise in construction costs, as shown in the LAO March 2016 report.¹⁵ Real construction wages declined during the mid-2000’s housing boom, and the average real BCCW wages have been stagnant since industry growth restarted in 2011.

Conclusion

California needs to increase its overall housing supply in order to maintain the quality of life for its residents, to build an equitable and competitive economy, and to continue to progress towards its ambitious environmental goals. The scale of the shortage suggests that such an effort will take years. A residential construction industry that attracts and retains a skilled workforce is central to that project.

Given that direct construction labor comprises 15% of project development costs, construction worker payroll growth has lagged industry price & profit growth, the housing industry has room to absorb wage increases for the men and women building the housing. Because housing affordability amongst blue collar construction workers is also declining—particularly amongst workers of color in high cost metropolitan and coastal regions—incorporating wage standards into a housing development streamlining package is a reasonable and cost-effective approach for boosting overall supply while helping to close the affordability gap for hundreds of thousands of California families.

¹ Author's calculations of Bureau of Economic Analysis per capital construction GDP table.

² Analysis of Current Population Survey, March supplement, by Frank Manzo, Midwest Economic Institute, La Grange, IL

³ *An Effectiveness Assessment and Cost-Benefit Analysis of Registered Apprenticeship in 10 States Final Report*, by Debbie Reed, et al., Mathematica Policy Research, 2012

⁴ *BUILDING FOR THE FUTURE Construction Economics Market Conditions in Construction*, Gilbane Building Company 2016 Edition.

⁵ *A Tool Kit to Close California's Housing Gap: 3.5 Million Homes By 2025*, McKinsey Global Institute, October 2016.

⁶ Prevailing wages are minimum wages and benefits paid to construction workers on publicly supported construction projects that are determined based on the rate paid to the greatest number of workers in a particular craft and region where the work is performed.

⁷ Research on California housing costs that use standard statistical methods report prevailing wage project cost impacts of 9-12 percent. Littlehale (forthcoming) analyzed the ACHS dataset and estimates prevailing wage costs of only half that magnitude. Other drivers of costs, such as inefficiencies of scale, are greater.

⁸ The AHCS is an empirical housing development cost study intended to measure the factors that influence the cost of building affordable rental housing in California and forms the basis of the cost breakdown for the major project cost components such as structure, site preparation, and soft costs, permitting, impact, and developer fees, and other costs related to particular projects (elevators, parking, public meetings, etc.).

⁹ "The Economic Census is the U.S. Government's official five-year measure of American business and the economy," according to the United States Census Bureau. Together with the AHCS, Economic Census data allow us to understand the entire cost structure of housing and the firms building the housing. We averaged the 2007 and 2012 Census of Construction for this analysis due to the particular conditions the industry found itself in during the survey years. In 2007 the housing bubble put the entire construction industry (NAICS 23) at full capacity and at peak profitability with \$216 billion in business, however in 2012 the industry just began to recover, doing only \$148 billion in business, a 31% decline. Multifamily housing (236116) declined from more than \$3.6 billion in business to just under \$2.6 billion, a 28% decline. Our construction labor share estimates are weighted averages of both multifamily residential contractors and specialty trade contractors.

¹⁰ We examined average BCCW trends in comparison to various construction industry price indices tracked by the Federal Reserve; in every instance BCCW wages increased less than the price index.

¹¹ Because a sizable number of the BMR projects are done by non-profit developers we assume here that the developer fee is intended to cover the specific administrative expenses associated with a project without room for profit.

¹² The AHSC had an average per-unit land price of \$24,000 and only one project with land costs in excess of \$100K per unit in its 2010-2012 database. By 2016, the \$100K/unit threshold has become common in the Bay Area for affordable housing projects. As an extreme example for market rate projects, KB Homes paid \$470K/unit for a fully entitled .76 acre parcel in San Francisco.

¹³ Author's calculations US Census Bureau of American Community Survey 2010-2014 microdata; IPUMS-USA, University of Minnesota, www.ipums.org.

¹⁴ Based on regression analysis of U.S. Census Current Population Survey public use microdata, via the Center for Economic Policy Research.

¹⁵ See Figure 6, <http://www.lao.ca.gov/reports/2015/finance/housing-costs/housing-costs.aspx>